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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

THE PEOPLE OF THE STATE OF ILLINOIS ex rel. JAMES E. RYAN, Attorney General of Illinois,

Petitioner,

v.

JAMES TOWERS,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In *Kelly v. Robinson*, 479 U.S. 36 (1986), this Court interpreted section 523(a)(7) of the Bankruptcy Code as excepting restitution awards in state criminal cases from discharge in Chapter 7 bankruptcies.

The question presented by this petition is:

Whether, in light of the similar punitive and deterrent effect of restitution in criminal and civil enforcement actions, section 523(a)(7) of the Bankruptcy Code excepts from discharge in Chapter 7 bankruptcies restitution awards payable to governmental units in civil consumer fraud actions filed in state court when the awards will be used to compensate injured consumers?

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The People of the State of Illinois *ex rel.* James E. Ryan, Attorney General of Illinois, respectfully petition for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The order of the court of appeals denying rehearing is not reported but may be found at 1999 U.S. App. LEXIS 467 (App. 60). The opinion of the court of appeals is reported at 162 F.3d 952 (App. 1). The district court's opinion is reported at 217 B.R. 1008 (N.D. Ill. 1998) (App. 36). The bankruptcy court's opinion is not reported (App. 11).

JURISDICTION

The United States Court of Appeals entered its judgment on December 9, 1998 (App. 1). The People filed a timely petition for rehearing with a suggestion for rehearing *in banc* on December 23, 1998. The court of appeals denied the petition in a January 12, 1999 order (App. 60). This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

§ 523 Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * *

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of filing the petition;

11 U.S.C. § 523(a)(7).

505/7 Injunctive and other relief.

Whenever the Attorney General or a State's Attorney has reason to believe that any person is using, has used, or is about to use any method, act or practice declared by this Act to be unlawful, and that proceedings would be in the public interest, he or she may bring an action in the name of the People of the State against such person to restrain by preliminary or permanent injunction the use of such method, act, or practice. The Court, in its discretion, may exercise all powers necessary, including but not limited to: injunction; revocation, forfeiture or suspension of any license, charter, franchise, certificate or other evidence of authority of any person to do business in this State; appointment of a receiver, dissolution of domestic corporations or association suspension or termination of the right of foreign corporations to do business in this State; and restitution.

In addition to the remedies provided herein, the Attorney General or State's Attorney may request and the Court may impose a civil penalty in a sum not to exceed $50,000 against any person found by

> the Court to have engaged in any method, act or practice declared unlawful under this Act. In the event the Court finds the method, act or practice to have been entered into with the intent to defraud, the court has the authority to impose a civil penalty in a sum not to exceed $50,000 per violation.

815 Ill. Comp. Stat. 505/7 (1996).

STATEMENT OF THE CASE

The Attorney General's State Court Action Against Towers

The Illinois Attorney General's office filed a civil action in 1986 against James Towers and other defendants in the Circuit Court of Cook County, Illinois. The Attorney General alleged that Towers engaged in unfair and deceptive conduct that violated section 2 of the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 Ill. Comp. Stat. 505/2 (1996). According to the state court complaint, Towers and his company, Update Financial Services Corporation, charged homeowners an application fee to obtain new financing to avoid mortgage foreclosures, and had the homeowners place money in escrow accounts. Towers promised the homeowners that he would return the escrow funds and a part of the application fee if he was unable to find adequate financing. The Attorney General alleged that Towers breached this promise in many instances (App. 1).

After Towers filed his first Chapter 7 bankruptcy petition in 1987, the Bankruptcy Court lifted the automatic stay to allow the Attorney General to proceed with the state court action. Towers then defaulted, and

additionally failed to show up at the hearing on damages. The state court entered a judgment order in 1991 directing Towers to pay the Attorney General $210,082.34 in restitution, a $50,000 civil penalty, and $50,000 as reimbursement for the state's investigative costs. The judgment order listed the names of Towers' customers and the amounts owed to each because of the fraudulent conduct of Towers and his company (App. 1-2).

Towers' 1995 Bankruptcy And Proceedings On The Attorney General's Complaint To Determine Whether Towers' Debt Was Discharged In Bankruptcy.

Towers filed a second Chapter 7 bankruptcy petition in 1995. The Attorney General then filed a complaint with the Bankruptcy Court seeking a declaration that Towers' obligations under the 1991 judgment order were exempt from discharge under 11 U.S.C. § 523(a)(7). The Attorney General filed a motion for summary judgment and materials in support of the motion (Docs. 13A, 13B). In those filings, the Attorney General argued that the restitution component of the state court judgment was exempt from discharge, relying in part on *Kelly v. Robinson*, 479 U.S. 36 (1986), in which this Court held that restitution obligations imposed in State criminal cases are exempt from discharge under section 523(a)(7). The Attorney General also contended that the $50,000 civil penalty was exempt from discharge under the same provision, but acknowledged that the $50,000 award intended as reimbursement for investigative costs was discharged.

The Bankruptcy Court ruled that the restitution portion of the judgment was discharged, citing section

523(a)(13) of the Bankruptcy Code, a provision enacted by Congress in 1994, which creates an exception to discharge for restitution orders issued under title 18 of the United States Code. 11 U.S.C. § 523(a)(13). The Bankruptcy Court reasoned that the failure of Congress to include in section 523(a)(13) restitution orders issued in state court actions meant that Congress did not intend to exempt such orders from discharge. The Bankruptcy Court agreed with the Attorney General that the $50,000 civil penalty was exempt from discharge (App. 29-32).

The Attorney General's Appeal To The District Court

The Attorney General appealed the Bankruptcy Court's decision to the United States District Court for the Northern District of Illinois. The District Court reversed the Bankruptcy Court and held that the restitution award was excepted from discharge under section 523(a)(7). The District Court stated that Congress did not intend that section 523(a)(13) supersede this Court's decision in *Kelly*. Instead, because *Kelly* applied only to restitution orders issued by State courts, Congress enacted section 523(a)(13) merely to clarify that certain restitution orders issued by Federal courts were also exempt from discharge (App. 47-49).

The District Court stated that *Kelly* had left open the question of whether restitution payable to a governmental unit in a civil fraud action is exempt from discharge under section 523(a)(7). The District Court went on to conclude that, like the criminal restitution in *Kelly*, the restitution in this case was intended primarily to fur-

ther the state's interest in punishing and deterring wrongdoing rather than to compensate the victims. (App. 56-58). The District Court noted that the Fourth Circuit Court of Appeals had recently held in *U.S. Dept. of Housing and Urban Development v. Cost Control Marketing & Sales Management of Virginia*, 64 F.3d 920 (4th Cir. 1995), that restitution ordered in a civil case brought by a government agency was excepted from discharge under section 523(a)(7) despite the agency's intention to use at least some of the payments to compensate the debtor's victims. Relying upon *Cost Control Marketing* and language from *Kelly*, the District Court concluded that the restitution portion of the state court judgment against Towers was exempt from discharge under section 523(a)(7). (App. 57-58).

Towers' Appeal To The United States Court Of Appeals For The Seventh Circuit

Towers appealed to the United States Court of Appeals for the Seventh Circuit, which reversed the District Court's decision. The Seventh Circuit concluded that the state-court-ordered restitution met all but one of the requirements of section 523(a)(7). The unmet criterion was the one stating that the amount in question must be "payable to and for the benefit of a governmental unit." 11 U.S.C. § 523(a)(7). (App. 6-7).

Although the restitution was payable to the Attorney General, the Seventh Circuit held that it was not for the Attorney General's benefit. The Seventh Circuit believed that the Attorney General would receive no financial benefit from the restitution payments because he intended to turn the payments over to Towers' victims and was required to do so under Illinois law, and

it distinguished *Cost Control Marketing* on the ground that the government agency therein was not required to turn the restitution payments over to the victims. (App. 6-8). While it acknowledged that there was language in *Kelly* suggesting that an intangible benefit such as deterrence of fraud could satisfy section 523(a)(7), the Seventh Circuit held that the benefit criterion of the provision is met only if the governmental unit receives a pecuniary benefit. The Seventh Circuit stated that governmental bodies seeking to deter fraud could actually experience a pecuniary detriment if their efforts resulted in less fraudulent conduct because of the possibility that this would result in budget decreases (App. 7-8).

The Attorney General filed a timely petition for rehearing with suggestion for rehearing *in banc*. The Seventh Circuit denied the petition in an order dated January 12, 1999 (App. 60).

REASONS FOR GRANTING THE WRIT

I.

THE SEVENTH CIRCUIT'S DECISION CONFLICTS WITH THE FOURTH CIRCUIT'S HOLDING IN *COST CONTROL MARKETING* AND WITH LANGUAGE FROM THIS COURT'S DECISION IN *KELLY v. ROBINSON* INDICATING THAT AN INTANGIBLE BENEFIT TO A GOVERNMENTAL UNIT SUCH AS THE DETERRENCE OF FRAUD SATISFIES SECTION 523(a)(7) OF THE BANKRUPTCY CODE.

In *Kelly v. Robinson*, 479 U.S. 36, 49-54 (1986), this Court interpreted section 523(a)(7) of the Bankruptcy Code (11 U.S.C. § 523(a)(7)) and held that it excepts restitution awards in state criminal cases from dis-

charge in Chapter 7 bankruptcies. This Court observed that Congress did not intend to interfere with the remedies available in such cases to achieve the goals of rehabilitation and deterrence. *Id.* at 52. Restitution awards in civil consumer fraud actions brought by state agencies have a similar punitive and deterrent effect and, like criminal restitution awards, are designed primarily to protect the public interest rather than private parties. *See, e.g., People ex rel. Hartigan v. Lann*, 225 Ill. App. 3d 236, 240, 587 N.E.2d 541 (1st Dist. 1992); *In re Luskin's, Inc.*, 213 B.R. 107, 111 (D. Md. 1997). Despite the similar purpose of criminal and civil restitution awards, however, the United States Court of Appeals for the Seventh Circuit has accorded a narrow interpretation of the section 523(a)(7) discharge exemption as applied to restitution awards in civil enforcement actions brought by governmental units. This Court should grant *certiorari* because the Seventh Circuit's decision will have an adverse impact on the ability of states to enforce their consumer protection laws and will allow civil restitution awards to be discharged in many instances. This Court should also grant *certiorari* because the decision creates a conflict between the Fourth and Seventh Circuits.

Under the Seventh Circuit's holding in this case, James Towers' restitution obligation arising from a civil consumer fraud action was discharged in his Chapter 7 bankruptcy because the Illinois Attorney General intended to use the payments to compensate Towers' victims. *In the Matter of James Towers*, 162 F.3d 952 (7th Cir. 1998) (App. 1). This decision is inconsistent with a Fourth Circuit decision holding that restitution payable to a government agency as a result of a civil

enforcement action was exempt from discharge under section 523(a)(7) of the Bankruptcy Code despite the agency's intention to use some or all of the payments to compensate the debtor's victims. *U.S. Dept. of Housing and Urban Development v. Cost Control Marketing & Sales Management of Virginia, Inc.*, 64 F.3d 920, 927-28 (4th Cir. 1995). This conflict needs to be resolved because most States have statutes allowing specified governmental entities to seek restitution in civil consumer fraud actions,[1] and the Seventh Circuit's decision creates substantial uncertainty about the dischargeability of civil restitution awards in Chapter 7 bankruptcies. State officials who enforce consumer protection laws need to know whether there is a risk that civil restitution will be discharged in bankruptcy so they can make informed decisions about whether to

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[1] *See* Ala. Code § 8-19-8(e) (1998); Alaska Stat. § 45.50.501(b) (1998); Ariz. Rev. Stat. § 44-1528 (1998); Cal. Bus. and Prof. Code § 17535 (1998); Colo. Rev. Stat. § 6-1-110 (1998); Conn. Gen. Stat. § 42-110m (1998); Ga. Code Ann. § 10-1-397 (1998); Haw. Rev. Stat. § 487-14(a); 815 Ill. Comp. Stat. 505/7 (1996); Idaho Code § 48-606(1)(c) (1998); Ind. Code Ann. § 24-5-0.5-4(c)(2) (1998); Iowa Code Ann. § 714.16(7) (1998); Kan. Stat. Ann. § 50-632 (1998); Ky. Rev. Stat. §§ 367.190, 367.200 (1998); La. Rev. Stat. Ann. § 51:1407-08 (1998); Me. Rev. Stat. tit. 5, § 209 (1998); Mass. Gen. Laws Ann. ch. 93A §4 (1998); Mich. Comp. Laws Ann. § 445.910 (1998); Miss. Code Ann. § 75-24-10 (1998); Mo. Rev. Stat. § 407.100(4) (1998); N.H. Rev. Stat. Ann. § 358-A:4 (1999); N.Y. Exec. Law § 63.12 (1998); N.Y. Gen. Bus. Law § 350-j (1998); N.C. Gen. Stat. § 75-15.1 (1998); Okla. Stat. Ann. tit. 15, § 751 (1998); Or. Rev. Stat. § 646.636 (1998); Pa. Stat. Ann. tit. 73, § 201-4.1 (1998); R.I. Gen. Law § 6-13.1-5(c) (1998); S.C. Code Ann. § 39-5-50(b) (1998); S.D. Codified Laws § 37-24-29 (1998); Tenn. Code Ann. § 47-18-108 (1998); Vt. Stat. Ann. tit. 9, § 2458(b)(2) (1998); Wash Rev. Code Ann. § 19.86.080 (1999); Wyo. Stat. Ann. § 40-12-106 (1997).

seek restitution or alternative penalties such as fines in consumer protection actions.

Section 523(a)(7) of the Bankruptcy Code automatically exempts from discharge in a Chapter 7 case any: 1) "fine, penalty or forfeiture," 2) "that is payable to and for the benefit of a governmental unit," and 3) "is not compensation for actual pecuniary loss." 11 U.S.C. § 523(a)(7). This Court has not directly addressed the issue of whether restitution payable to a governmental unit in a civil enforcement action is exempt from discharge in a Chapter 7 bankruptcy under this provision, although it has held that restitution awarded in state criminal proceedings is exempt from discharge under section 523(a)(7). *Kelly v. Robinson*, 479 U.S. 36, 44-54 (1986). This Court has also stated in *dictum* that section 523(a)(7) applies to fines and penalties awarded in both criminal *and* civil cases. *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 560, 562-63 (1990).

Relying on *Kelly* and *Davenport*, the Fourth Circuit held that the section 523(a)(7) exempts from discharge all penalties payable to governmental units in civil or criminal matters, including those intended to provide restitution to injured citizens. *Cost Control Marketing*, 64 F.3d at 927-28. The Fourth Circuit stated that, as long as the government has a penal interest in enforcing a restitution obligation, the fact that injured victims may receive compensation for their pecuniary loss makes no difference, and the debt will be exempt from discharge. *Id.* at 928. The Seventh Circuit's narrow interpretation of section 523(a)(7) is inconsistent with the construction of the provision by this Court and the Fourth Circuit.

Although the Seventh Circuit held that the restitution award in the state court judgment against Towers met two of the three section 523(a)(7) criteria, the Court held that the award did not satisfy the "payable to and for the benefit of a governmental unit" standard. *In the Matter of James Towers*, 162 F.3d 952, 955-56 (7th Cir. 1998) (App. 6-9). The Court reasoned that this standard was not met because the Attorney General would not receive a financial benefit from the restitution payments, which the Attorney General intended to forward to Towers' victims in accordance with the state court's judgment order and Illinois law.[2] *Id.*

The Seventh Circuit acknowledged that language in *Kelly* suggests that intangible benefits such as deterrence of fraud can satisfy the above requirement. *Id.* at 956 (App. 7). But the Court stated that the context in which the word "benefit" appears in section 523(a)(7) implies that the benefit must be derived from the money that is "payable to" the governmental unit. *Towers*, 162 F.3d at 956 (App. 7-8). The Seventh Circuit even suggested that the deterrence of fraud could be a detriment to a unit of government seeking to achieve

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[2] The Seventh Circuit relied on a provision of the Illinois Consumer Fraud Act stating that, when a receiver is appointed in a case brought under the Act, any person who submits satisfactory proof that he or she has suffered damages because of the defendant's violation of the Act may participate with general creditors in the distribution of assets, and that the receiver shall settle the estate and distribute the assets under the court's direction. 815 Ill. Comp. Stat. 505/8 (1996), cited in *Towers*, 162 F.3d at 955 (App. 6-7). The Court's reliance on this provision is questionable because the Attorney General was never appointed as a receiver in the state-court action. (App. 7).

that end because of the possibility that success would result in a budget decrease. *Id.*

The Seventh Circuit attempted to reconcile its holding with *Kelly* by noting that the state governmental agency kept the criminal restitution payments in *Kelly* because that agency was the victim that had been defrauded by the debtor. *Towers*, 162 F.3d at 956. There is no language in *Kelly* indicating that the holding was limited to those facts or motivated by the narrow factor cited by the Seventh Circuit. Instead, this Court stated that, while restitution is forwarded to the victim, the context in which restitution is imposed undermines the proposition that it is a judgment for the victim's benefit. *Id.* at 52. This Court recognized that criminal restitution awards are intended instead to serve the state's interests, and it stated as follows:

> Because criminal proceedings focus on the State's interests in rehabilitation and punishment, rather than the victim's desire for compensation, we conclude that restitution orders imposed in such proceedings operate "for the benefit of" the State . . . Those interests are sufficient to place restitution orders within the meaning of § 523(a)(7).

Kelly, 479 U.S. at 53. This language does not merely suggest that intangible benefits to a governmental unit such as the deterrence of fraud satisfy section 523(a)(7); it compels that conclusion.

The Seventh Circuit's attempt to distinguish *Cost Control Marketing* on the basis that the restitution order in that case did not require the Department of Housing and Urban Development to turn over the payments to the debtors' victims (*Towers*, 162 F.3d at 955)

is also unpersuasive. The Department admitted in that case that it intended to forward some or all of the restitution payments to the debtor's victims, as the Attorney General intended to do here. *Cost Control Marketing*, 64 F.3d at 927. Furthermore, there is no language in *Cost Control Marketing* indicating that the decision was premised on the government's ability to retain the restitution payments. Instead, the Fourth Circuit stated that the automatic discharge exemption in section 523(a)(7) applies to all civil and criminal penalties payable to governmental units, including those that are designed to provide restitution to private citizens, under this Court's broad reading of the provision in *Kelly* and *Davenport*. *Cost Control Marketing*, 64 F.3d at 927-28. The Fourth Circuit explicitly stated that, as long as the government has a penal interest in enforcing a restitution obligation, the fact that injured victims may receive compensation for their pecuniary loss makes no difference, and the debt will be exempt from discharge. *Id.* at 928.

The Fourth Circuit's application of *Kelly* to restitution in civil cases is appropriate because civil enforcement actions like the one at issue here serve largely the same purpose as criminal proceedings. Criminal cases are brought because of the state's responsibility to protect its citizens rather than a desire to benefit private parties. *See Kelly*, 479 U.S. at 52. Likewise, a consumer fraud case brought by a government agency "is essentially a law enforcement action designed to protect the public, not private parties." *People ex rel. Hartigan v. Lann*, 225 Ill. App. 3d 236, 240, 587 N.E.2d 541 (1st Dist. 1992); *In re Luskin's, Inc.*, 213 B.R. 107, 111 (D. Md. 1997). Indeed, section 7 of the Illinois

Consumer Fraud and Deceptive Business Practices Act authorizes the Attorney General to file consumer fraud actions only when such "proceedings would be in the public interest." 815 Ill. Comp. Stat. 505/7 (1996).

In proceedings brought under the Illinois Consumer Fraud Act, the Attorney General initially seeks injunctive relief to stop practices that are unlawful under the Act, and the court may employ other remedies, such as the imposition of a fine or a restitution award. *Id.* As in criminal cases, victims have no control over the decision to award restitution or the amount of restitution awarded in cases brought by the Attorney General under the Consumer Fraud Act. *Id.*; *Kelly*, 479 U.S. at 52. As was previously noted in this section, most other States also have statutes that authorize the imposition of restitution when the Attorney General or another authorized unit of government files a consumer protection action.

The conflict between the Fourth and Seventh Circuits means that state officials who enforce consumer protection laws outside these circuits do not know whether civil restitution awards that may be turned over to third-party victims will be automatically exempt from discharge under section 523(a)(7). This Court should grant *certiorari* in order to resolve this conflict so that state officials who enforce consumer protection laws can make informed decisions about whether to seek restitution or instead seek alternative civil penalties in consumer protection actions.

Until the conflict is resolved, the Seventh Circuit's decision will discourage states in civil consumer protection cases from seeking restitution awards that will help the state achieve its law enforcement objec-

tives and will help injured consumers. The decision will instead encourage states to seek the imposition of fines that will be exempt from discharge under section 523(a)(7). In the case at bar, the state court imposed a $50,000 fine against James Towers and ordered the payment of about $210,000 in restitution. The Seventh Circuit acknowledged that the entire $260,000 would have been exempt from discharge under section 523(a)(7) if the State court had merely imposed a fine in that amount. *Towers*, 162 F.3d at 955; *see also In re Tapper*, 123 B.R. 594, 605 (Bankr. N.D. Ill. 1991) (fine imposed under Illinois Consumer Fraud Act held exempt from discharge under section 523(a)(7)).

Instead, because the Attorney General sought and received a restitution award, most of the penalties against Towers will be discharged in bankruptcy if the Seventh Circuit's decision is left undisturbed. Because of the possibility that wrongdoers will evade much of their liability through a discharge in bankruptcy, the Seventh Circuit's decision will make state officials reluctant to include in civil consumer fraud complaints requests for restitution awards, and they may opt to seek only the imposition of nondischargeable fines that the states will retain. States should not be discouraged from seeking restitution, which this Court has recognized as a particularly effective penalty because it compels wrongdoers to confront in concrete terms the harm caused by their actions. *Kelly*, 479 U.S. at 49, n.10. Civil restitution awards serve the state's interests by deterring fraudulent conduct and forcing wrongdoers to disgorge money received from such conduct, while incidentally benefitting victims by restoring the money to them. *See Cost Control Marketing*, 64 F.3d at 927-28.

This Court should grant *certiorari* to avoid the adverse impact that the Seventh Circuit's decision will have on the State's flexibility in choosing the appropriate types of penalties in civil consumer fraud actions. *See Kelly*, 479 U.S. at 49.

II.

STATES SHOULD NOT BE FORCED TO DEFEND RESTITUTION AWARDS FROM CIVIL FRAUD ACTIONS IN FEDERAL BANKRUPTCY COURTS.

The Seventh Circuit attempted to justify its restrictive reading of section 523(a)(7) by stating that government units can rely upon other discharge exemption provisions in section 523(a). *Towers*, 162 F.3d at 956. These include section 523(a)(2), which applies to obligations resulting from fraud; section 523(a)(4), which applies to obligations stemming from embezzlement or larceny; and section 523(a)(6), which applies to obligations resulting from willful or malicious injury caused by the debtor to another entity or its property. 11 U.S.C. § 523(a)(2),(4),(6). But this Court recognized in *Kelly* that forcing states to rely upon these discharge exemptions "would create uncertainties and impose undue burdens upon state officials." *Kelly*, 470 U.S. at 48.

Those burdens and uncertainties would result from the fact that a debt covered by one of these subsections is exempt from discharge only if the creditor makes a timely request for a hearing before the Bankruptcy Court and the court agrees that the subsection applies. 11 U.S.C. § 523(c)(1). By contrast, obligations covered by section 523(a)(7) are automatically excepted from discharge without the requirement of a hearing before the Bankruptcy Court, and a governmental unit may

raise this discharge exemption at any time. Fed R. Bank. P. 4007(b); *Towers*, 162 F.3d at 953.

Allowing states to rely upon the automatic discharge exemption in section 523(a)(7) minimizes the possible adverse impact that Federal bankruptcy proceedings may have upon the efforts of state officials to effectively enforce their laws, as this Court recognized in *Kelly*. This Court rejected an argument in *Kelly* that the discharge exemptions provided in sections 523(a)(2), (a)(4), and (a)(6) were sufficient to protect states, and it said instead that state officials should not have to defend criminal judgments in Federal Bankruptcy Court. *Kelly*, 479 U.S. at 48. Likewise, state officials should not be compelled to defend civil fraud judgments in Federal Bankruptcy Court, when criminal judgments and civil fraud judgments are both intended to protect the public from wrongdoing rather than to benefit private parties. *See Kelly*, 479 U.S. at 52; 815 Ill. Comp. Stat. 505/7 (1996).

The Seventh Circuit's decision that section 523(a)(7) is inapplicable to civil restitution awards that may be forwarded to victims will force state officials to litigate in the Bankruptcy Court the dischargeability of restitution awards obtained in civil enforcement actions. In some instances, states will be forced to completely retry civil fraud cases before Bankruptcy Courts because of differences between fraud under section 523(a)(2) and statutory consumer fraud that will hinder the application of issue preclusion. *See Kelly*, 479 U.S. at 48, n.8; *Azimi v. Ford Motor Co.*, 977 F. Supp. 847, 852 n.5 (N.D. Ill. 1997) (scienter and actual reliance on the deception are not elements of a statutory consumer fraud claim in Illinois).

Additionally, the Seventh Circuit's decision will require states to comply with deadlines of short duration in order to challenge the discharge of restitution obligations from civil fraud cases. A party seeking the discharge of a debt in a Chapter 7 bankruptcy on the ground of fraud must file a complaint within 60 days of the first date set for the first meeting of creditors, which must be scheduled between 20 and 40 days of the commencement of a voluntary bankruptcy case. 11 U.S.C. § 301; Fed R. Bank. P. 2003(a), 4007(c). This only gives states a period of between 80 and 100 days to file complaints to challenge the discharge of debts on the basis of fraud, depending on the date set for the first meeting of creditors.

Complying with a short deadline like this will be especially difficult if a state is unaware of a potential consumer fraud action against a debtor until it receives a debtor's list of creditors including the state as a creditor and mentioning the possible obligation. *See* 11 U.S.C. § 521(1); Bankruptcy Rule 1007 (both requiring a bankruptcy debtor to file a list of creditors). This scenario can occur because the Bankruptcy Code defines the term "creditor" as including any entity with a claim against the debtor, 11 U.S.C. § 101(10), and the Code also defines the term "claim" broadly, including contingent, disputed, and unliquidated claims in the definition. 11 U.S.C. § 101(5); *see also In re Dow Corning Corp.*, 211 B.R. 545, 560 (Bankr. E.D. Mich. 1997).

The automatic discharge exemption provided in section 523(a)(7) avoids the possible impediment to law enforcement efforts that results if states must rely instead upon sections 523(a)(2), (a)(4), and (a)(6). This Court recognized in *Kelly* that state officials should not be

forced to follow and participate in Federal bankruptcy proceedings to uphold restitution awards that they have received in state court. *Kelly*, 479 U.S. at 48 n.8. The Seventh Circuit panel deciding this case has imposed that burden upon states that use restitution awards as an enforcement tool to deter wrongdoing and to incidentally help the victims of wrongful acts committed by bankruptcy debtors. The Attorney General of Illinois respectfully asks this Court to grant *certiorari* because of the likelihood that the Seventh Circuit's decision will hinder State efforts to enforce consumer protection laws.

CONCLUSION

For these reasons, James E. Ryan, Attorney General of Illinois, respectfully asks this Court to issue a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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APPENDIX

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 98-1522

IN THE MATTER OF:

JAMES TOWERS,

Debtor-Appellant.

STATE OF ILLINOIS,

Appellee.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 97 C 6005—**James B. Moran**, *Judge.*

ARGUED SEPTEMBER 11, 1998—DECIDED DECEMBER 9, 1998

Before POSNER, *Chief Judge*, and BAUER and EASTERBROOK, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* James Towers took advantage of people in financial distress. Through his firm Update Financial Services Corp. Towers charged a fee for new financing that would stave off impending foreclosures on home mortgages. Towers promised the homeowners that part of the application fee, and all funds that the homeowners had been required to put into an escrow account, would be returned if refinancing could not be arranged. But he did not keep that promise, and the State of Illinois alleged in an action commenced in 1986 under the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 to 505/12, that he never intended to honor his word. Towers defaulted in the state

proceeding and did not appear for a prove-up of damages; the state court found in 1991 that Towers had defrauded his customers and imposed a civil penalty of $50,000, ordered Towers to reimburse the state for investigative costs of $50,000, and directed him to pay about $210,000 as restitution. The order included a list of Tower's customers with amounts due to each.

Towers has had financial problems of his own. He filed a petition in bankruptcy and in 1987 received a discharge under Chapter 7. In 1995 Towers filed a second Chapter 7 petition and received a second discharge. But Illinois asked the bankruptcy court to declare that neither discharge relieves Towers of his obligation to repay his victims in the refinancing scheme. The statutory exception to discharge for money obtained by fraud, see 11 U.S.C. §523(a)(2)(A), offers no benefit to Illinois because §523(c) requires claims based on §523(a)(2) to be made in the bankruptcy itself, which was not done. See also Fed. R. Bankr. P. 4007(c) (when §523(c) applies, creditors who want an exception to discharge must present their claims no later than 60 days after the first creditors' meeting). Likewise the state forfeited any argument that the debt stemmed from "larceny" and therefore was nondischargeable under §523(a)(4). But §523(a)(7) precludes discharge of fines, penalties, and forfeitures. Claims based on this exception may be raised "at any time." Fed. R. Bankr. P. 4007(b). Debts covered by this subsection thus pass through bankruptcy unaffected; the creditor may disregard the proceedings and enforce its rights later, as Illinois has sought to do. But to prevail under §523(a)(7) the creditor must show that the debt is "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss". Bankruptcy Judge Ginsberg concluded that the $50,000 civil penalty is not dischargeable under this language, but that the $50,000 debt for investigative costs has been discharged. These conclusions are no longer in controversy. What remains to be determined is the status of the $210,000 in restitution to the victims of Towers' scam.

Judge Ginsberg recognized that *Kelly v. Robinson*, 479 U.S. 36 (1986), treats restitution ordered in a criminal case as a "penalty . . . payable to and for the benefit of a governmental unit" but concluded that the meaning of §523(a)(7) changed when, in 1994, Congress added §523(a)(13) to the Bankruptcy Code. The new subsection exempts from discharge "any payment of an order of restitution issued under title 18, United States Code". Applying the canon *expressio unius est exclusio alterius*, the bankruptcy judge concluded that because the state's restitution order was not issued under title 18 (the criminal title of the Code) it therefore was subject to discharge. On appeal the district judge found this approach unpersuasive, 217 B.R. 1008 (N.D. Ill. 1998), as do we. A statute enacted in 1994 could not alter the effect of a discharge in 1987. *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211 (1995). But even had §523(a)(13) been added to the Bankruptcy Code after *Kelly* (but before Towers' discharge in 1987) it would not have supported the bankruptcy judge's conclusion. Section 523(a)(7) has not been amended. Canons that assist in revealing the meaning of §523(a)(13) do not imply that a different subsection suddenly acquired a new meaning while its text was unaltered. If Congress wants to supersede the Supreme Court's decisions, it must amend the statute the Court has construed; continuity of text equals continuity of meaning. *Pierce v. Underwood*, 487 U.S. 552, 566-68 (1988); *Illinois Council on Long Term Care, Inc. v. Shalala*, 143 F.3d 1072, 1075-76 (7th Cir. 1998).

The bankruptcy judge's unstated premise must have been that different parts of the Bankruptcy Code do not address the same subject (or the same economic transactions), so that if a given subsection does not protect a creditor from discharge, then no other subsection does so. That's an implausible view of the legislative process. Different provisions added at different times may intersect, and courts endeavor to prevent overlap from causing accidental destruction. Section 523(a)(13) makes double

sure that restitution awarded as part of a federal criminal judgment cannot be discharged in bankruptcy but does not imply, for example, that civil fraud judgments that *might* have been made the object of criminal restitution, but weren't, now may be discharged despite §523(a)(2)(A). And if §523(a)(13) does not alter the scope of the fraud exception to discharge, or the larceny exception in §523(a)(4), it does not contract the scope of §523(a)(7) either. Congress had good reason to put restitution in federal criminal cases beyond the scope of debate by adding §523(a)(13). The principal interpretive tool used in *Kelly*—the proposition that courts are "reluctant to interpret federal bankruptcy statutes to remit state criminal judgments" (479 U.S. at 44)—does not apply to federal prosecutions. Read without the aid of this doctrine of federalism, §523(a)(7) offers weak support for exempting restitution orders from discharge, for it does not mention restitution, and it operates only if the penalty is "for the benefit of a governmental unit"—a condition not easy to satisfy when the governmental body is collecting for private creditors. These limitations on the scope of §523(a)(13) not only give §523(a)(13) an independent role to play but also come back to haunt Illinois in this case, as we shall see.

After concluding that §523(a)(13) does not affect the interpretation of §523(a)(7), the district court had to determine whether the restitution order meets the criteria of §523(a)(7). *Kelly* dealt with a criminal restitution order, and as we have mentioned its animating concern was limited to criminal cases. Nonetheless, *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990), implies in dictum that *Kelly* is applicable to civil restitution orders. (*Davenport* held that restitution orders are not exempt from discharge under Chapter 13 of the Bankruptcy Code, a conclusion speedily undone by the enactment of 11 U.S.C. §1328(a)(3), but without affecting one way or the other the status of the dictum.) *Department of Housing & Urban Development v. Cost Control Marketing & Sales Management of Virginia, Inc.*, 64 F.3d

920, 927-28 (4th Cir. 1995) (*CCMV*), concludes from the combination of *Kelly*'s holding and *Davenport*'s dictum that federal civil restitution orders designed as sanctions for wrongdoing may meet the requirements of §523(a)(7). Following *CCMV*, the district judge concluded that Towers' restitution obligation likewise is exempt from discharge.

To see whether this is sound, we must work through the language of §523(a)(7). There are three requirements. The debt must reflect:

- "a fine, penalty, or forfeiture"
- "payable to and for the benefit of a governmental unit"
- that is "not compensation for actual pecuniary loss"

It is easy enough to call restitution under the Illinois Consumer Fraud and Deceptive Business Practices Act "a fine, penalty, or forfeiture". The state enforces its laws for the benefit of all citizens, not just the victims of a given flimflam. The $50,000 penalty unquestionably satisfies §523(a)(7); if instead of ordering restitution the state court had selected a "penalty" of $260,000 (the harm caused by the wrongful acts, plus an additional fine), this larger sum also would have been covered. Breaking an exaction into components does not make it less a fine, penalty, or forfeiture.

As for the third requirement, restitution is "compensation for actual pecuniary loss" from the perspective of the victim, who is made whole by the award. But, as *Kelly* observed, restitution usually is not compensation for *the government's* pecuniary loss. Governments seek restitution to promote law enforcement by deterrence as well as by compensation, and Illinois was not a victim of Towers' fraud except to the extent criminal activity induced the state to expend part of its law-enforcement budget. The bankruptcy judge concluded that the $50,000 earmarked to reimburse Illinois for the costs of investigation and

prosecution is excluded by this language and therefore dischargeable (but see *In re Zarzynski*, 771 F.2d 304 (7th Cir. 1985)); the $210,000, however, is "not compensation for actual pecuniary loss".

But the final requirement—that the amount be "payable to *and for the benefit of* a governmental unit"—is not so readily satisfied. The state court's order directs Towers to pay the $210,000 *to* the Attorney General of Illinois, but *for the benefit of* the victims of his fraud. In *Kelly* the governmental unit kept the restitution, for the state was itself the victim (the crime was welfare fraud). In *CCMV* the Department of Housing and Urban Development collected the restitution and, the fourth circuit stressed, was not under any legal obligation to distribute the money to persons harmed by the defendant's acts. 64 F.3d at 927. If an agency collects money and deposits it into the state's (or federal government's) treasury, the fact that the government has a policy of compensating victims of crimes and civil wrongs does not make the collection less "for the benefit" of the government; so, too, tax collections are for the public benefit even when the government spends money as fast as it comes in.

Illinois contends that it, like the Department of Housing and Urban Development in *CCMV*, has no obligation to pass the money through to the victims. Perhaps this would be so under a beady-eyed reading of the restitution order; the judge did not state in so many words that the Attorney General must redistribute to the victims whatever can be squeezed out of Towers. No one doubts, however, that the Attorney General *will* distribute the money to the victims; its brief informs us that "the State intends to forward restitution payments to the victims if it succeeds in collecting from Towers" and that "the State is receiving no pecuniary benefit" from this activity. Payment is not wholly gratuitous, either. Section 8 of the state law provides in part:

> Any person who has suffered damages as a result of the use or employment of any unlawful practices and

> submits proof to the satisfaction of the court that he has in fact been damaged, may participate with general creditors in the distribution of the assets to the extent he has sustained out-of-pocket losses. In the case of a partnership or business entity, the receiver shall settle the estate and distribute the assets under the direction of the court.

815 ILCS 505/8. Although the Attorney General may respond that he was not formally appointed as the receiver of Update Financial Services Corp., this language makes it clear that a person who collects money designed to make victims whole must use that money to make them whole "under the direction of the court"; he cannot divert it to other good ends. The state court's restitution order, which lists victims by name and amount of loss, is the sort of "direction" that leads to a distribution. Surely the Attorney General of Illinois can't disburse state funds to victims of fraud without legal authorization. The only possible authority to pay money to Towers' victims come from the combination of §8 and the state court's order; neither suggests that distribution is elective on the Attorney General's part.

Perhaps one could reply that the state's benefit need not be pecuniary. Deterrence of fraud is a benefit to all of the state's citizens. If restitution adds to the punch of the criminal law, then so much the better. Some language in *Kelly* suggests this possibility. But the context in which "benefit" appears—"*payable to and* for the benefit of a governmental unit"—implies that the "benefit" in question is the benefit of the money that is "payable to" the governmental unit. In *Kelly* the government received and kept the money; not so here. Citizenry at large may get the benefit of deterrence, but neither the people of Illinois nor any governmental unit receives a *financial* benefit from the restitution that Towers has been directed to pay, and the "governmental unit" does not receive any benefit from general deterrence either. Although potential victims gain from improved deterrence, governmental bodies ex-

perience the process as a cost—not only the outlay needed to achieve deterrence but also the possibility that, if the level of crime falls, then the budget of those governmental units devoted to crime suppression may decline.

If there were no way to protect the deterrence effects of restitution except by hammering away at "for the benefit of" until it fit the mold, then a court might be tempted. But it is not necessary. Section 523(a)(2) prevents the discharge of debts attributable to fraud (as Towers' debts were); §527(a)(4) exempts debts that stem from embezzlement or larceny; §523(a)(6) exempts debts that stem from "willful and malicious injury by the debtor to another entity or to the property of another entity". These three exemptions cover the gamut of crimes. The only reason Illinois (and Towers' victims) cannot take advantage of these exclusions from discharge is that they snoozed through his bankruptcies. 11 U.S.C. §523(c). Instead of asking the bankruptcy court in 1987 to rule that Towers' obligations to his victims could not be discharged under §523(a)(2)(A), the state asked only that the bankruptcy court lift the automatic stay so that it could pursue its action in state court. That request was unnecessary; state law-enforcement actions are outside the scope of the stay to begin with. 11 U.S.C. §362(b)(4). Our point is not that Illinois was *required* to make an argument under §523(a)(2)(A) in 1987; it is, rather, that the state took its chances by neglecting the proceeding. We do not have to give an acontextual reading to "benefit" in §523(a)(7) in order to protect victims of fraud; the only real interest that supports the state's proposed reading of "benefit" is the interest in deferring litigation about dischargeability until after the conclusion of the state-court proceeding. But that's not a weighty interest; to the contrary, by enacting §523(c) Congress made it clear that the fraud exception to discharge should be litigated in the bankruptcy case. To read "benefit" in §523(a)(7) the way Illinois prefers would be to undermine the public interest in having claims wrapped up as part of the original bank-

ruptcy case. An approach that simultaneously tortures the language of §523(a)(7) and undermines the function of §523(c), in order to protect a creditor that did not take advantage of its opportunities in the original bankruptcy proceeding, has little to recommend it.

Civil restitution under the Illinois Consumer Fraud and Deceptive Business Practices Act is payable to, but not for the benefit of, the Attorney General of Illinois. It is therefore not protected from discharge by 11 U.S.C. §523(a)(7).

REVERSED

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT — WITH ORAL ARGUMENT

Date: December 9, 1998

BEFORE:

Honorable RICHARD A. POSNER, Chief Judge
Honorable WILLIAM J. BAUER, Circuit Judge
Honorable FRANK H. EASTERBROOK, Circuit Judge

No. 98-1522

IN RE: JAMES TOWERS

Debtor-Appellant

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 97 C 6005, James B. Moran, Judge.

The judgment of the District Court is REVERSED, with costs, in accordance with the decision of this court entered on this date.

App. 11

[Dated July 7, 1997]

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Case No. 95 B 01042
	)	
JAMES TOWERS,	)	Chapter 7
Debtor.	)	
	)	Hon. Robert E. Ginsberg
	)	
THE PEOPLE OF THE STATE OF ILLINOIS *ex rel.*, JAMES E. RYAN, ATTORNEY GENERAL OF ILLINOIS,	)	
Plaintiff,	)	
v.	)	Adv. No. 96 A 00329
	)	
JAMES TOWERS,	)	
Defendant.	)	

MEMORANDUM, OPINION, AND ORDER

The People of the State of Illinois, *ex rel.* James E. Ryan, Attorney General of Illinois ("State") filed a complaint seeking to have obligations, including a civil penalty, costs, and restitution, imposed on James Towers by a state court judgment, found nondischargeable pursuant to section 523(a)(7) of the Bankruptcy Code (11 U.S.C. section 523(a)(7)).

This matter is before the Court on cross motions for summary judgment. It is the State's position that there are no issues of material fact between the parties to this proceeding, and that the obligations, including the

civil penalty, costs and restitution provided for in the state court judgment are not dischargeable as a matter of law, as set forth in section 523(a)(7) of the Bankruptcy Code. Towers opposes the State's motion and also moves for summary judgment, seeking an order that declares the obligations imposed by the state court judgment are dischargeable in the instant Chapter 7 bankruptcy case. For the reasons stated below, the Court partially grants the State's motion for summary judgment, and denies Towers' motion for summary judgment. Thus, the Court finds that the debt owed by Towers to the State for restitution is dischargeable under section 523(a)(13) of the Bankruptcy Code, but that the debt Towers owes the State for penalties is not dischargeable under section 523(a)(7) of the Bankruptcy Code.

Jurisdiction

The Court has jurisdiction over this matter under 28 U.S.C. § 1334(b) as a matter arising under section 523(a) of the Bankruptcy Code. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I) as a proceeding to determine the dischargeability of debts. This matter is before the Court pursuant to Local Rule 2.33 of the United States District Court for the Northern District of Illinois automatically referring bankruptcy cases and proceedings to this Court for hearing and determination.

Standards for Summary Judgment

To prevail on a motion for summary judgment, the movant must meet the criteria set out in Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings under the Federal Rule of Bankruptcy Procedure 7056. Summary judgment is appropriate if the entire record, including pleadings, depositions, answers to interrogatories, admissions on file, and any affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Fed. R. Bankr. P. 7056; *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552 (1986).

Summary judgment is granted to avoid unnecessary trials when there is no genuine issue of material fact in dispute. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 585-86, 106 S. Ct. 1348, 1355, 89 L. Ed. 538 (1986). The movant bears the burden to show that no genuine issue of material fact is in dispute. *Anderson*, 477 U.S. at 248; *Matsushita*, 475 U.S. at 585-86; *Celotex*, 477 U.S. at 322. Once the motion for summary judgment is supported by a *prima facie* showing that the moving party is entitled to judgment as a matter of law, Rule 56(e) provides that a party opposing the motion may not rest upon the mere allegations or denials in its pleadings; the response of that party must set forth specific facts showing that there is a genuine issue for trial. *Celotex*, 477 U.S. at 324; *Anderson*, 477 U.S. at 248; *Matsushita*, 475 U.S. at 587; *Doe v. Cunningham*, 30 F.3d 879, 882 (7th Cir. 1994); *Waldridge*, 24 F.3d at 920.

Procedure for Summary Judgment Motions

Local Rule 402.M of the Bankruptcy Rules adopted for this District requires the party moving for summary judgment to file, among other things, a detailed statement, known colloquially as a "402.M Statement." It consists of a statement of material facts as to which the movant contends there is no genuine issue. The 402.M statement "shall consist of short numbered paragraphs, including, within each paragraph specific references to the affidavits, parts of the record, and other supporting materials relied upon to support the facts set forth in that paragraph. Failure to submit such a statement constitutes grounds for denial of the motion." Local Rule 402.M, U.S. Bankruptcy Court, N.D. Illinois (1996).

The party opposing a summary judgment motion is required by Local Rule 402.N to respond to the movant's 402.M statement, paragraph by paragraph, and to set forth any material facts that would require denial of summary judgment, specifically referring to the record for support of each denial of fact.

Compliance with Local Rules 402.M and 402.N is not a mere technicality. Courts rely on the information presented in these statements to separate the facts about which there is a genuine dispute from those about which there is none. *American Ins. Co. v. Meyer Steel Drum, Inc.*, 1990 WL 92882 at *7 (N.D. Ill. June 27, 1990). The statements required by Rule 402 are not merely superfluous abstracts of the evidence. Rather, they are intended to assist the court in determining what facts are in dispute and to point the court to specific evidence in the record that supports a party's

contentions on each of these questions of fact. In other words, the pleadings required by the Local Rules assist the court in fulfilling its most basic task in resolving a summary judgment motion, *i.e.*, determining whether there actually are unresolved issues of material fact between the parties. *Waldridge v. American Hoechst Corp.*, 24 F.3d 918, 921 (7th Cir. 1994).

In the instant proceeding, the State filed a 402.M statement as part of its summary judgment motion. That statement contains numbered paragraphs setting out allegedly uncontested facts. While the State's statement is not perfect (for example, it does not specifically refer to portions of pleadings and affidavits), it is sufficient to satisfy the requirements of Rule 402.M.

Towers, on the other hand, has not filed any document that could qualify as a Rule 402.N statement in opposition to the State's motion for summary judgment. Towers filed an answer to both the dischargeability complaint and the motion for summary judgment as well as a memorandum in response to the State's motion for summary judgment. While Towers also filed a pleading titled "Response to Plaintiff's Statement as to Material Facts," that document refers to Rule 402.M, when it technically should have been styled a 402.N statement. Of course, if that were the only defect in the Defendant's attempt at complying with Local Rule 402, the court would overlook it and deem the document sufficient to satisfy the respondent's obligations under the Local Rules. Unfortunately, the document filed by Towers in response to the State's 402.M statement suffers from more than mere technical defects.

Towers' apparent attempt at filing a Rule 402.N statement does not comply with the clear requirements

of the Local Rules governing motions for summary judgment. For example, Towers' Response to Plaintiff's Statement as to Material Facts" does not contain numbered paragraphs corresponding to the State's 402.M statement. It merely attaches Towers' barebones affidavit that contains no information relevant to the instant dispute, and then incorporates the "Answer to Verified Complaint" Towers filed in the suit the State filed against him in Illinois state court. That suit alleged that Towers, and others, violated the Consumer Fraud and Deceptive Business Practices Act (hereinafter referred to as "State Court Litigation"). Towers does not otherwise refer to the record or affidavits or provide other materials in his "Response to Plaintiff's Statement as to Material Facts" and in opposition to the State's motion for summary judgment, as required by the Local Rules. Thus, Towers did not comply at all with the Local Rules dealing with summary judgments in the Bankruptcy Court. Towers' failure to comply with the Local Rule 402.N amounts to an admission by him of all of the material facts set out in the State's 402.M statement. Local Rule 402.N(3)(b), U.S. Bankruptcy Court, N.D. Illinois (1996).

Undisputed Facts

The undisputed material facts with respect to both parties' motions for summary judgment as determined by this court from the various documents filed by the parties are as follows:

Towers was president of Update Financial Services Corp. ("UFSC"). (State's Verified Complaint pr. 3 (hereinafter, "Complaint"), Tower's Answer to Verified Com-

plaint (hereinafter, "Answer") ¶3), a consumer debt financing business. A representative of UFSC contacted people whose homes were in danger of foreclosure, and entered into contracts with them for UFSC to find financing for these debtor homeowners which would be used by the homeowners to save their homes from foreclosure. (Complaint ¶¶10, 11; Answer ¶11). UFSC charged the homeowners a fee and commission for its work in finding the necessary financing. (Complaint ¶11; Answer ¶11). At least some of UFSC's customers were required to enter into an agreement to escrow funds for closing. (Complaint ¶12; Answer ¶12). All escrow funds and a portion of the application fee were to be refunded if UFSC could not arrange a loan large enough to prevent the foreclosure. (Complaint ¶14; Answer ¶14).

On June 4, 1986, the State brought a suit in the Circuit Court of Cook County, Chancery Division, case number 86 CH 5458, under the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 *et seq.*, against Towers individually and in his official capacity as president of UFSC. The State also sued several of Towers' fellow officers, including Percy Middleton (secretary), Charles Crawford (vice president), Arthur Bishop (loan officer), and Virgil Tolbert (vice president and marketing director). Several banks were also sued as nominal defendants. The suit alleged that Towers and his colleagues were guilty of fraudulent business practices in their operation of UFSC. (Answer ¶¶1-9, Towers' Answer to State's Motion for Summary Judgment (hereinafter, Summary Judgment Answer") ¶2). The State alleged, among other things, that Towers and the other defendants failed to refund

monies due customers from their escrow accounts, and failed to return the application fee when UFSC's financing efforts failed. Towers' attorney filed an unverified answer to the Verified Complaint, disputing the consumer fraud claims made by the State.

The case remained pending for a number of years in the Chancery Division of the Circuit Court of Cook County. Most of what occurred procedurally while the matter was in the state court has no bearing on the dischargeability issues involved in the instant proceeding. Eventually, the state court entered a Default Order against Towers and Percy Middleton. (Summary Judgment Answer ¶5). On August 22, 1991, the state court entered a "Final Judgment Order and Permanent Injunction Order ("Final Judgement") against Towers and Percy Middleton. The entry of the Final Judgment followed a prove up hearing at which Towers did not appear, either personally or by counsel. Although the events giving rise to the entry of the Default Order and the Final Judgment are disputed, it is not disputed that the Final Judgment was entered by the state court on August 22, 1991. The Final Judgment provided that Towers and Middleton were enjoined from engaging in the business of mortgage banking in Illinois. The Final Judgment also required Towers and Middleton to pay a state civil penalty of $50,000.00, investigative costs of $50,000, and restitution of $210,082.34.

On April 2, 1987, while the State Court Litigation was pending, Towers filed a petition under chapter 7 of the Bankruptcy Code (Case No. 87 B 4905) ("the 1987 Bankruptcy Case"). On August 7, 1987, the automatic stay was modified in the 1987 Bankruptcy Case to permit the State to proceed with the State Court Litigation

against the Debtor. Although it held a claim against Towers, the State did not file a complaint to determine the dischargeability of the debt owed by Towers to the State. *See* 11 U.S.C. section 523(c), Fed. R. Bankr. P. 4007. An order of discharge was entered on August 6, 1987 in the 1987 Bankruptcy Case, and the case was closed on October 15, 1987.

On January 18, 1995, Towers filed another chapter 7 petition (Case No. 95 B 1042). That case now pends before this court. On April 7, 1995, the State filed the instant complaint seeking to except from discharge the civil penalty, restitution payment and investigative costs[1] assessed against Debtor in the Final Judgment in the Consumer Protection case in the state court. An order of discharge was entered on May 26, 1995.[2]

Towers' Motion for Summary Judgment

In his Cross-Motion for Summary Judgment, Towers alleges that his obligations to the State under the Final Judgment were discharged by the discharge he received in the 1987 Bankruptcy Case, and therefore the State's instant complaint must fail as a matter of law. Towers

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[1] The State has subsequently conceded that its investigative costs are dischargeable in both cases because they are not within the scope of section 523(a)(7) of the Code, and the statute of limitations for actions under sections 523(a)(2) or (4) of the Code, provisions that could, according to the State, operate to make the costs nondischargeable, has expired. *See* 11 U.S.C. section 523(c), Fed. R. Bankr. P. 4007.

[2] The entry of the order of discharge does not affect the instant proceeding since the discharge only discharges dischargeable debts. 11 U.S.C. §523(a).

argues that because the State's claim[3] against Towers arising from the Final Judgment existed during the pendency of the 1987 Bankruptcy Case, the State was required to bring its action to have Towers' obligations under the Final Judgment found nondischargeable in accordance with the time limit set forth in Federal Rules of Bankruptcy Procedure Rule 4004(a).[4] It is true that the State did not object to Towers' discharge in the 1987 Bankruptcy Case and an order of discharge was entered in that case. Based on these facts, which the State concedes, Towers concludes that his obligations to the State arising under the Final Judgment were discharged. This Court concludes that Towers' analysis is incorrect.

Towers' analysis fails because Towers has confused the difference between the discharge of a debtor in a bankruptcy case and the dischargeability of a debt in a

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[3] "Claim" is defined in section 101(5) of the Bankruptcy Code as:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

[4] Federal Rules of Bankruptcy Procedure 4004(a) provides in relevant part: In a chapter 7 liquidation case a complaint objecting to the debtor's discharge under section 727(a) of the Code shall be filed not later than 60 days following the first date set for the meeting of creditors held pursuant to section 341(a). . .

bankruptcy case. In Chapter 7 cases, Federal Rule of Bankruptcy Procedure 4004 only fixes the time for filing a complaint objecting to the discharge of the debtor under 11 U.S.C. § 727(a). In the instant proceeding, the State does not seek to block, nor has the State ever sought to block, the receipt by Towers of a discharge under 11 U.S.C. § 727(a) in either bankruptcy case. Rather, the State brought its complaint seeking to have this court hold that certain debts which the State alleges Towers owes to it are not covered by the discharge Towers has received in this case and the 1987 Bankruptcy Case because those debts are nondischargeable under 11 U.S.C. § 523. This proceeding involves a dispute over dischargeability of debts, not over Towers' discharge. Therefore, Bankruptcy Rule 4004 has no application in the instant proceeding.

By the same token, the State contends that the discharge Towers received in the 1987 Bankruptcy Case applied only to dischargeable debts. Under Federal Rule of Bankruptcy Procedure 4007(b),[5] "any creditor" may bring a proceeding seeking a determination of the dischargeability of a debt "at any time." Even if the case is closed, a creditor can have the case reopened to file a complaint to determine the dischargeability of a debt. Thus, there is no time limit for filing complaints seeking to determine the dischargeability of a debt (other than complaints brought under section 523(c) of the Code and Bankruptcy Rule 4007(c)). The instant pro-

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[5] Federal Rule of Bankruptcy Procedure Rule 4007(b) provides in relevant part: A complaint other than under section 523(c) may be filed at any time. A case may be reopened without payment of an additional filing fee for the purpose of filing a complaint to obtain a determination under this rule.

ceeding does not involve a complaint brought under either section 523(c) of the Code or Bankruptcy Rule 4007(c). *U.S. v. Wood*, 925 F.2d 1580, 1582 (7th Cir. 1991); *In re Ellsworth*, 158 B.R. 856 (M.D. Fla. 1993); *In re Williams*, 96 B.R. 149, 151 (Bankr. N.D. Ill. 1989). Thus, the State can bring an action at any time to determine whether the debt Towers allegedly owes to the State was included in the discharge the Debtor received in either bankruptcy case, even if the case has been closed. Accordingly, Towers' motion for summary judgment, based on his receipt of a discharge in the 1987 Bankruptcy Case, is denied.

State's Motion for Summary Judgment

Civil Penalty

In Paragraph G of the Final Judgment in the state court case, a $50,000 civil penalty is imposed against Towers. Paragraph G provides in relevant part:

> Percy Middleton and James Towers are hereby ordered to pay the amount of Fifty Thousand Dollars ($50,000) as civil penalties to the State of Illinois a provided by Section 7 of the Consumer Fraud Act.

The issue before the court is whether the civil penalty imposed on Towers in the Final Judgment is nondischargeable under section 523(a)(7) of the Code, which provides in relevant part:

> A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a

> governmental unit, and is not compensation for actual pecuniary loss . . .

The State alleges that the civil penalty awarded to the State in the Final Judgment gives rise to a non-dischargeable debt under section 527(a)(7) of the Code.[6] The State argues that there are no material facts in dispute with respect to the dischargeability of the debt under section 523(a)(7) of the Code and that the State is entitled to judgment in its favor on its section 523(a)(7) claim.

Not surprisingly, Towers disagrees with the State's position and asserts that issues of material fact concerning his behavior exist which preclude the entry of summary judgment. Towers essentially contends that he has no obligations to the State that can be found nondischargeable. Towers asserts that the Final Judg-

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[6] In its Complaint to Determine Dischargeability, the State alleges that the $50,000 civil penalty and $50,000 in investigative costs assessed in the Final Judgment are not dischargeable under section 523(a)(7) of the Bankruptcy Code and that the $210,000 in restitution is not dischargeable under sections 523(a)(2)(A) and/or (a)(4) of the Bankruptcy Code. Apparently recognizing that the time limitations for bringing certain dischargeability actions imposed by Fed. R. Bankr. P. 4007 has long run, and bars dischargeability actions under section 523(a)(2) and (4), the State has conceded that it has no cause of action under those sections. *See also* 11 U.S.C. section 523(c). However, in its Reply in Support of its Motion for Summary Judgment, the State seems to have switched sides and now argues that the restitution amount, as well as the civil penalty, are not dischargeable under section 523(a)(7). Towers has had the opportunity to respond to the State's change in position. *See* Reply of James Towers In Support of His Cross Motion for Summary Judgment. Accordingly, the Court will treat the Complaint as one brought entirely under section 523(a)(7) of the Bankruptcy Code.

ment entered in the state court case cannot be given collateral estoppel preclusive effect[7] since it was entered by default, there was no trial on the merits of the claims asserted by the State in the Complaint, and there was no evidence or trial regarding Towers' personal culpability for any illegal actions. Moreover, Towers disputes the losses of the UFSC customers listed in the Final Judgment, contends that no evidence was provided in the state court case personally implicating Towers in any wrongdoing, and any improper actions were performed by the other defendants to the state court case. According to Towers, any obligations he does have to the State are in the nature of restitution and are dischargeable under section 523(a)(7) of the Bankruptcy Code, and that such obligations can be found nondischargeable only under sections 523(a)(2) or (4) of the Bankruptcy Code and that such actions are time barred. Thus, it is Towers' position that the State's motion for summary judgement should be denied and the complaint should be dismissed. (Towers' Memorandum of Law in Response to Plaintiff's Motion for Summary Judgment).[8]

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[7] For collateral estoppel to prevent relitigation of an issue, four requirements must be satisfied: (1) the issue sought to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) the determination of the issue must have been essential to the final judgment; and (4) the party against whom estoppel is invoked must have been fully represented in the prior action. *Klingman v. Levinson*, 831 F.2d 1292, 1295 (7th Cir. 1987).

[8] In his Response to Adversary Complaint to Determine Dischargeability of Debt, Towers admits that he listed the State as a creditor on his bankruptcy schedules (para. 5), but then

(continued...)

The collateral estoppel preclusive effect of the Final Judgment is irrelevant to the court's determination of whether the civil penalty is nondischargeable under section 523(a)(7) of the Code. Towers' culpability is not implicated by section 523(a)(7) of the Code. That section requires only that the court determine whether the civil penalty imposed on Towers by the state court is a "fine, penalty, or forfeiture." Towers' culpability is relevant only under sections 523(a)(2), (4) and (6) of the Code, and the State is not proceeding under those theories.[9] Thus, the court does not reach the issue of whether the Final Judgment bars relitigation of certain issues involving Towers' actions and liability.

The Final Judgment is not preclusive on the question of whether the civil penalty is a penalty under the provisions of section 523(a)(7) of the Code since that issue was not actually litigated in the state court. Whether the civil penalty assessed in the Final Judgment is a penalty within the context of section 523(a)(7) of the Code is a question of law for the court to decide. *See e.g., In re Kish*, 204 B.R. 122, 129 (Bankr. D.N.J. 1997) (the court must decide whether motor vehicle sur-

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[8] (...continued)
denies that the State holds a claim in the amount of $100,000 against his assets arising from civil penalties and costs (para. 6). Towers also asserts that he believed that he had been dismissed from the lawsuit and that he had no knowledge that the Final Judgment was entered against him (para. 6, 18, 23). These allegations or believes were not included in Towers' abortive 402.N Statement or supported in his affidavit. Therefore, the court gives no weight to these alleged disputed facts.

[9] As noted *supra*, the State has conceded any causes of action against Towers under sections 523(a)(2) and (4), and has never asserted a cause of action under section 523(a)(6).

charges are penalties within the scope of section 523(a)(7) of the Code); *U.S. Dept. of Housing & Urban Dev. v. Cost Control Marketing & Sales Management of Virginia, Inc.*, 64 F.3d 920 (4th Cir. 1995) (district court's characterization of disgorgement remedy as a penalty was affirmed). Thus, it is for this court to decide whether the civil penalty imposed on Towers by the Final Judgment is a "penalty" within the scope of section 523(a)(7) of the Bankruptcy Code. 11 U.S.C. section 523(a)(7).

The Final Judgment has not been challenged on appeal, and the judgment itself is therefore binding on the parties, even if findings concerning Towers' actions are not entitled to collateral estoppel preclusive effect. In the Final Judgment, Towers was ordered to pay $50,000 as a "civil penalty" to the Attorney General of the State of Illinois. The Final Judgment itself distinguishes between, and separates, the civil penalty, investigative costs and restitution. Therefore, the civil penalty imposed on Towers by the Final Judgment is a "penalty" as that term is used in section 523(a)(7) of the Code. It is also clear that a civil penalty to be paid to the Attorney General, and authorized by Section 7 of the Consumer Fraud and Deceptive Business Practices Act ("Consumer Fraud Act") fits squarely within the parameters of section 523(a)(7) of the Code. *In re Tapper*, 123 B.R. 594, 604 (Bankr. N.D. Ill. 1991). Thus, the $50,000 civil penalty is not dischargeable.

Restitution

The Final Judgment, paragraph F, obligates Towers to pay $210,082.34 in restitution:

> PERCY MIDDLETON and JAMES TOWERS are hereby ordered to pay the amount of TWO HUNDRED AND TEN THOUSAND EIGHTY TWO DOLLARS AND THIRTY FOUR CENTS ($210,082.34) as restitution to the consumers harmed by defendants' unlawful acts and business practices, as provided by Section 7 of the Consumer Fraud Act. A list of the names and addresses of consumers and the amount of the restitution to each is attached as Appendix A.

The State argues that this obligation imposed on Towers is not dischargeable under section 523(a)(7) of the Code. The State relies on *Kelly v. Robinson*, 479 U.S. 36, 107 S.Ct. 353 (1986) to support its argument that the restitution provided for in the Final Judgment is nondischargeable. In *Robinson*, the Supreme Court held that restitution orders, as part of a state criminal sentence, were not dischargeable under section 523(a)(7) of the Bankruptcy Code. The Court stated: "[although restitution does resemble a 'judgment for the benefit of' the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of restitution awarded or over the decision to award restitution. Moreover, the decision to impose restitution generally does not turn on the victim's injury, but on the penal goals of the State. . ." *Id.* at 52, 107 S.Ct. at 362. Therefore, because the restitution order was part of the state's system to punish and rehabilitate criminals, and not to compensate victims, the restitution obligation was not dischargeable. *Id.* at 52, 107 S.Ct. at 362.

Applying the *Robinson* analysis to the facts in the instant proceeding, the State makes several points in support of its argument that the restitution is not dischargeable under section 523(a)(7) of the Code. First, the restitution imposed on Towers in the Final Judgment was to punish Towers, protect the citizens of Illinois and promote Illinois' penal interests. Second, like the criminal restitution at issue in *Robinson*, Towers' victims had no control over the amount of restitution, if any, that would be awarded. Third, the context of section 7 of the Consumer Fraud Act indicates that its purpose is to punish the perpetrator of the fraud, not compensate the victim. *See Robinson,* 479 U.S. at 53, 107 S.Ct. at 362. Fourth, even if the assessed penalty is calculated with reference to the victims' damages, that fact is irrelevant. *See U.S. Dept. of Housing and Urban Development v. Cost Control Marketing & Sales Management of Virginia*, 64 F.3d 920 (4th Cir. 1995). Having the amount of restitution relate to the damages sustained by the victims serves a more precise deterrent effect than another measure of penalty, such as a flat fine. *See Robinson,* 479 U.S. at 52 n. 10, 107 S.Ct. at 361 n. 10. Fifth, Section 7 of the Consumer Fraud Act does not permit the victims to sue the State to collect the restitution amounts from the State. In fact, the Final Judgment provides that all payments must be made to the Office of the Attorney General. The amount of restitution awarded to the state under section 7 of the Consumer Fraud Act is to punish the wrongdoer. Moreover, the Final Judgment does not impose on the State any obligation to remit the funds received from Towers to the victims, nor does section 7 of the Act impose such a burden or duty on the State. *See id.*

Again, Towers disagrees with the State. According to Towers, the restitution assessed in the Final Judgment is not "for the benefit of a governmental unit" and is not "not compensation for actual pecuniary loss" since by its terms, the restitution obligation was designed to compensate the victims for their actual pecuniary loss. Thus, Towers argues that the restitution obligation is dischargeable under section 523(a)(7) of the Code.

Surprisingly, neither Towers nor the State cite section 523(a)(13) of the Bankruptcy Code. Section 523(a)(13), added to the Code in 1994, provides:

> A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> (13) for any payment of an order of restitution issued under title 18, United States Code. . .

The Court believes that section 523(a)(13) is dispositive, and that the State's analysis of the nature of the restitution obligation imposed on Towers by the Final Judgment has been superseded by the addition of section 523(a)(13) of the Code. *See U.S. Dept. of Housing and Urban Development v. Cost Control Marketing & Sales Management of Virginia*, 64 F.3d 920 (4th Cir. 1995). Under the plain meaning of section 523(a)(13) of the Code, the restitution portion of the Final Judgment is dischargeable because it does not arise under title 18 of the United States Code.

Section 523(a)(13) of the Code makes only federal restitution nondischargeable,[10] it is silent on the issue

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[10] Compare section 523(a)(13) of the Code with section 1328(a)(3) of the Code. In chapter 13 cases, all restitution obli-

(continued...)

of restitution orders imposed under state law. The doctrine of *inclusio unius est exclusio alterius* ("The inclusion of one is the exclusion of another.") applies to the analysis, and is, in fact, determinative. By specifying that a particular class of restitution obligations are not dischargeable, Congress excluded all other classes of restitution from being nondischargeable. *See BFP v. Resolution Trust Corp.*, 114 S.Ct. 1757, 1761 (1994) (when Congress includes particular language in one section of a statute but not in another, it is presumed that Congress acted intentionally); *U.S. v. Reorganized CF&I Fabricators of Utah, Inc.*, 116 S.Ct. 2106, 2110 (1996) (Congress knows how to be specific: Congress could have included a provision calling certain taxes excise taxes if it wished them to be classified as excise taxes and therefore priority claims); *In re Turner*, 195 B.R. 476, 483 (Bankr. N.D. Ala. 1996) (when Congress knows how to say something but chooses not to, its silence is controlling).

Although this Court has some doubt that Congress intended to make state court ordered restitution obligations dischargeable in Chapter 7 cases while federal court ordered restitution obligations are not dischargeable in Chapter 7 cases, this Court must apply the statute as written. The plain language of section 523(a)(13) of the Code refers specifically to title 18 of the United States Code in making restitution a nondischargeable

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[10] (...continued)
gations are nondischargeable regardless of whether they were created under state or federal law. *See e.g., Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 110 S.Ct. 2126 (1990) (state criminal restitution is dischargeable in a chapter 13 case.)

obligation. For whatever reason, Congress did not include state court orders within the scope of section 523(a)(13) of the Code. In contrast, section 1328 of the Code, governing the discharge of a debtor in a chapter 13 case, makes all restitution obligations, both state and federal, nondischargeable.[11] Thus, Congress knew how to make all restitution obligations nondischargeable. By specifying only restitution orders under the federal criminal statute, Congress knew how to specify those types of restitution orders it wanted to make nondischargeable. By including federal restitution obligations, Congress excluded state court restitution obligations. Congress' failure to include state restitution in section 523(a)(13) of the Code when it knew how to make all restitution obligations nondischargeable, makes the silence controlling. *See BFP v. Resolution Trust Corp.*, 114 S.Ct. at 1761; *CF&I Fabricators of Utah, Inc.*, 116 S.Ct. at 2110; *Turner*, 195 B.R. at 483.

Basic statutory interpretation principles require that statutes be interpreted so as to give meaning to all parts of the statute. *In re Bloomingdale Partners*, 170 B.R. 984, 989 (Bankr. N.D. Ill. 1994). There is no con-

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[11] Section 1328(a) provides in relevant part:

> (a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt—
>
> > (3) for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime.

flict between sections 523(a)(7) and (13) of the Code and it is possible to give logical meaning to both provisions of the Code. Section 523(a)(7) of the Code is concerned with the dischargeability of fines and penalties, with no distinction between state and federal penalties, and expressly excludes "compensation for actual pecuniary loss" from its scope. Section 523(a)(13) is concerned with those obligations that section 523(a)(7) expressly does not cover; restitution, and does not address fines or penalties. As a result, under section 523(a)(7) of the Bankruptcy Code, fines and penalties are not dischargeable, but compensation for pecuniary loss is dischargeable. However, under section 523(a)(13) of the Code, federal restitution, typically defined as that amount of money necessary to restore the injured party to its previous position, *see Black's Law Dictionary*, Sixth Edition, 1990, page 1313; *Texas American Oil Corp. v. U.S. Dept. of Energy*, 44 F.3d 1557 (Fed. Cir. 1995), is not dischargeable.

The Final Judgment obligates Towers to make several different payments: civil penalty, investigative costs, and restitution. Because the state court judge separately provided for penalty, costs and restitution, it is clear that the restitution must be different from a penalty or a cost, and that the state court judge intended the restitution to be treated as restitution, not a fine or penalty. Therefore, the restitution portion of the Final Judgment is subsumed within section 523(a)(13) of the Code. Accordingly, the restitution imposed on Towers in the Final Judgment is dischargeable since the restitution arose under state law.

Order

For the reasons stated above, the State's motion for summary judgment is granted in part and Towers' cross-motion for summary judgment is denied. The $50,000 civil penalty assessed against Towers in the Final Judgment is not dischargeable, and the restitution award assessed against Towers in the amount of $210,082.34, as well as the investigative costs, are dischargeable.

ENTERED:

/s/ Robert E. Ginsberg
Robert E. Ginsberg
United States Bankruptcy Judge

Dated: July 7, 1997

[Dated July 7, 1997]

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

	)	Chapter 7
	)	
James Towers,	)	Bankruptcy
Debtor.	)	No. 95 B 01042
	)	
The People of the State of Illinois ex rel., James E. Ryan, Attorney General of Illinois,	)	Adversary
	)	No. 95 A 00329
	)	
	)	
Plaintiff,	)	
v.	)	
	)	Judge
James Towers,	)	Robert E. Ginsberg
Defendant.	)	

ORDER

At Chicago, Illinois, in the District on the 7th day of July, 1997.

It is Ordered that for the reasons set forth in the MEMORANDUM, OPINION AND ORDER dated July 7, 1997, and this matter coming before the Court on the complaint of The People of the State of Illinois, *ex rel.* James E. Ryan, Attorney General of Illinois, plaintiff, to determine dischargeability of debt; the motion of plaintiff for summary judgment; and the cross-motion of James Towers, defendant, for summary judgment. For the reasons stated herein, the motion of The State of Illinois, plaintiff, is granted in part and the cross-motion of James Towers, defendant, is denied. The debt

owed by defendant to the State for a civil penalty in the amount of $50,000 is not dischargeable. The debt owed by defendant to the State for restitution in the amount of $210,082.34, as well as the investigative costs in the amount of $50,000, are dischargeable. Judgment is entered on plaintiff's behalf and the complaint is dismissed.

/s/ Robert E. Ginsberg
ROBERT E. GINSBERG
BANKRUPTCY JUDGE

[Dated January 30, 1998]

N THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
JAMES TOWERS,	)	
Debtor.	)	
	)	
THE PEOPLE OF THE STATE OF ILLINOIS ex rel. JAMES RYAN, ATTORNEY GENERAL OF ILLINOIS,	)	
Appellant,	)	
vs.	)	No. 97 C 6005
	)	
JAMES TOWERS,	)	
Appellee.	)	

MEMORANDUM AND ORDER

The People of the State of Illinois, ex rel. James E. Ryan, Attorney General of Illinois, (State) appeals that part of the order of the United States Bankruptcy Court entered on July 7, 1997, denying the State's motion for summary judgment (July 7 order). In its order, the bankruptcy court found that the debt owed by James Towers (Towers) to the State for restitution of $210,082.34 for violations of the Illinois Consumer Fraud and Deceptive Business Practices Act (ICFA), 815 ILCS 505/1 *et seq.*, is dischargeable under Chapter 7 of the Bankruptcy Code. On appeal, the State argues that the bankruptcy court erred in so finding and that the order for restitution is nondischargeable under 11

U.S.C. §523(a)(7), which excepts from discharge any debt that is "for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not for actual pecuniary loss . . . ." This court has jurisdiction pursuant to 28 U.S.C. §158(a). For the reasons stated herein, we reverse the bankruptcy court's order in relevant part and grant the State's motion for summary judgment.

BACKGROUND

The district court accepts the bankruptcy court's fact-findings unless clearly erroneous. Fed.R.Bankr.P. 8013; *see also, In re Tolona Pizza Products Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993). Since neither party disputes the facts in this case we accept the undisputed facts as set forth by the bankruptcy court in its July 7 order.

Towers was president of Update Financial Services Corporation (UFSC), a consumer debt financing business. A representative of UFSC contacted individuals whose homes were in danger of foreclosure, and entered into contracts with them for UFSC to find financing to save their homes from foreclosure. UFSC charged the homeowners a fee and commission for its work, and at least some of its customers were required to enter into an agreement to escrow funds for closing. All escrow funds and a portion of the application fee were to be refunded if UFSC could not arrange a loan large enough to prevent the foreclosure.

On June 4, 1986, the State brought suit in the Circuit Court of Cook County, Chancery Division (No. 86-CH-5458), under the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 *et seq.*,

against Towers, individually, and in his official capacity as president of UFSC (state court litigation). The State also sued several of Towers' fellow officers and several banks. The suit alleged that Towers and his colleagues were guilty of fraudulent business practices in their operation of UFSC. The State alleged, *inter alia*, that Towers and the other defendants failed to refund monies due customers from their escrow accounts, and failed to return the application fee when UFSC's financing efforts failed. Towers' attorney filed an unverified answer to the verified complaint, disputing the consumer fraud claims made by the State.

The case remained for a number of years in the Chancery Division of the Circuit Court. Eventually, the state court entered a default order against Towers and Percy Middleton, UFSC's secretary. On August 22, 1991, the state court entered a final judgment order and permanent injunction order (final judgment) against Towers and Middleton. The final judgment provided that Towers and Middleton were enjoined from engaging in the business of mortgage banking in Illinois. It also required Towers and Middleton to pay a state civil penalty of $50,000, investigative costs of $50,000, and restitution of $210,082.34.

On April 2, 1987, while the state court litigation was pending, Towers filed a petition under Chapter 7 of the Bankruptcy Code (No. 87-B-4905) (1987 bankruptcy case). On August 7, 1987, the automatic stay was modified in this bankruptcy case to permit the State to proceed with the pending state court litigation against Towers. Although it held a claim against Towers, the State did not file a complaint to determine the dischargeability of the debt owed by Towers to the State.

See 11 U.S.C. §523(c); Fed.R.Bankr.P. 4007. An order of discharge was entered on August 6, 1987 and the 1987 bankruptcy case was closed on October 15, 1987.

On January 18, 1995, Towers filed another Chapter 7 petition (No. 95-B-102), which is the subject of the present litigation. In response to Towers' petition, on April 7, 1995, the State filed its adversary complaint to determine dischargeability of debt, seeking to except from discharge the civil penalty, restitution payment, and investigative costs[1] assessed against Towers in the final judgment of the state court Consumer Fraud Act case. An order of discharge was entered on May 26, 1995. On June 2, 1995, Towers filed his response to the adversary complaint and on February 7, 1996, the State filed the instant motion for summary judgment, arguing that 11 U.S.C. §523(a)(7) excepts from discharge Towers' obligations for restitution in the amount of $210,082.34 and civil penalty in the amount of $50,000. On April 23, 1996, Towers filed a cross-motion for summary judgment, arguing that any claim of the State against him as debtor was discharged pursuant to Bankruptcy Rule 4004(c).

On July 7, 1997, the bankruptcy court issued its order granting in part the State's motion and denying Towers' motion. Specifically, the court held that the debt owed by Towers to the State for restitution is dischargeable under 11 U.S.C. §523(a)(13), but that the debt Towers owes the State for penalties is not dischargeable under 11 U.S.C. §523(a)(7). The State now appeals that por-

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[1] The State has subsequently conceded that its investigative costs are dischargeable in both cases because they are not within the scope of 11 U.S.C. §523(a)(7).

tion of the bankruptcy court's order finding that the debt owed to the State for restitution is dischargeable under §523(a)(13).

DISCUSSION

The district court reviews the bankruptcy court's legal conclusions under a *de novo* standard *In re UNR Indus.*, 986 F.2d 207, 208 (7th Cir. 1993). Since this matter is before the court on cross-motions for summary judgment, and since there are no material factual disputes between the parties, we review *de novo* whether the bankruptcy court was correct in denying in part the State's summary judgment motion by holding that Towers' obligation to pay the State restitution is dischargeable as a matter of law.

A motion for summary judgment may be granted when there are no issues of material fact and the movant is entitled to a judgment as a matter of law. Fed.R.Civ.P. 56(c); *Renovitch v. Kaufman*, 905 F.2d 1040, 1044 (7th Cir. 1990). The movant must point to those portions of the record that demonstrate the absence of any genuine issue of material fact, *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986), and all reasonable inferences are drawn in favor of the nonmovant, *see e.g.*, *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970); *Bank Leumi Le-Israel, B.M. v. Lee*, 928 F.2d 232, 236 (7th Cir. 1991). Summary judgment should be granted when it is clear that the plaintiff could not carry his burden of persuasion at trial on one or more elements. *See generally Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986).

In its final judgment the Illinois state court in the underlying Consumer Fraud Act case found that Towers was obligated to pay $210,082.34 in restitution. In its motion for summary judgment the State argued that this obligation is not dischargeable under § 523(a)(7) of the Bankruptcy Code[2]. That section provides as follows:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss . . . .

11 U.S.C. §523(a)(7). The State argued in its motion (and argues again here on appeal) that despite its apparent narrow scope of application, §523(a)(7) has been interpreted broadly to except from discharge all claims for criminal and civil restitution. *See Kelly v. Robinson*, 479 U.S. 36, 53 (1986) (holding that restitution obligations, imposed as conditions of probation in state criminal proceedings, are not dischargeable under §523(a)(7)); *United States Dept. of Housing & Urban*

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[2] In its complaint to determine dischargeability, the State initially alleged that the $ 210,082.34 in restitution was not dischargeable under §§523(a)(2) and/or (a)(4) of the Bankruptcy Code. The bankruptcy court noted that the statute of limitations for bringing certain dischargeability actions imposed by Fed.R.Bankr.P. 4007 had already run, thus barring dischargeability actions under those sections. Since the State conceded this much and changed its position in its motion for summary judgment, the bankruptcy court decided to treat the complaint as one brought entirely under §523(a)(7) of the Bankruptcy Code (July 7 order at 11, n.6). We will do the same.

Dev. v. Cost Control Marketing and Sales Management of Virginia, Inc. (CCMV), 64 F.3d 920, 927-28 (4th Cir. 1995) (finding that order of civil restitution in the form of a disgorgement of ill-gotten profits was "penal" in nature and therefore not dischargeable under §523(a)(7)), *cert. denied*, ___ U.S. ___, 116 S. Ct. 1673 (1996)). The State argued that since the restitution order against Towers was penal in nature and therefore "not in compensation of actual pecuniary loss," it was excepted from discharge under § 523(a)(7).

The bankruptcy court rejected the State's attempt to categorize the restitution order as a "fine, penalty, or forfeiture" which is excepted from discharge under §523(a)(7), instead holding that the restitution order in question was dischargeable under a separate provision of the Bankruptcy Code that was never discussed by either party, 11 U.S.C. §523(a)(13). That section provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> (13) for any payment of an order of restitution issued under title 18, United States Code.

11 U.S.C. §523(a)(13). The bankruptcy court concluded that §523(a)(13), which was enacted in 1994, superseded the expansive interpretation given to §523(a)(7) by *Kelly* and *CCMV*, by specifying the specific type of restitution obligations excepted from discharge. The court concluded that under the "plain meaning" of §523(a)(13), the restitution portion of the final judgment "is dischargeable because it does not arise under title 18 of the United States Code." (July 7 order at 17).

I. The Relation Between Bankruptcy Code §523(a)(7) and §523(a)(13)

The issue on appeal in this case, then, is the purely legal one of divining the meaning of apparently related, yet analytically distinct, provisions of the same statutory scheme, and determining which provision controls the outcome of this case. Specifically, we must define the parameters of §523(a)(13) as it relates to §523(a)(7) of the Bankruptcy Code and determine whether the two provisions overlap, are cumulative, or are mutually exclusive.

This issue involves the clash of competing theories of statutory construction and we therefore begin by setting forth the interpretive disagreement between the bankruptcy court and the State. The bankruptcy court relied on two separate maxims of statutory interpretation to justify its holding that §523(a)(13) disposes of the restitution claim at issue. First, the court stated that the doctrine of *inclusio unius est exclusio alterius* ("the inclusion of one is the exclusion of another") controls this case (July 7 order at 17). When construing statutory provisions under this doctrine, courts must presume that Congress acted intentionally and purposefully when it includes particular language in one section of a statute and excludes other language that it was capable of incorporating. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1994) ("'It is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another' . . . .").

Applying the doctrine to §523(a)(13), the bankruptcy court reasoned that by including a certain class of resti-

tution as nondischargeable under §523(a)(13) (*i.e.*, orders of restitution issued under title 18 of the United States Code), Congress intended to exclude all other classes of restitution from being nondischargeable (*i.e.*, orders of restitution issued under state law or under any federal law other than title 18). Thus, federal orders of restitution issued under title 18 are nondischargeable under the specific terms of §523(a)(13), and all other forms of restitution are dischargeable by negative implication.[3] The congressional silence with respect to state or non-title 18 federal restitution claims admits of only one permissible interpretation: Congress intended to make those forms of restitution dischargeable. According to the bankruptcy court, this conclusion is supported by the fact that other portions of the Bankruptcy Code—specifically §1328(a)(3)[4]—explicitly except from discharge both state and federal restitution obligations, demonstrating that Congress knew how to spe-

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[3] Although the bankruptcy court found the asymmetrical treatment of federal and state court restitution troubling, it concluded it must accept that result since "[f]or whatever reason, Congress did not include state court orders within the scope of section 523(a)(13) of the Code" (July 7 order at 18).

[4] Section 1328(a)(3), which applies in proceedings initiated under Chapter 13 of the Bankruptcy Code, provides in relevant part as follows:

> (a) As soon as practicable after completion by the debtor of all payments under the plan, . . . the court shall grant the debtor a discharge of all debts . . ., except any debt—
>
> (3) for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime.

11 U.S.C. §1328(a)(3).

cify the types of restitution orders it wanted to make dischargeable. The bankruptcy court therefore found that §523(a)(13) supersedes any contrary interpretation of the dischargeability of civil restitution orders offered under §523(a)(7). The restitution order in question in this case was held to be dischargeable, since it arose out of a state court judgment and therefore did not fall within the nondischargeable forms of restitution specified by §523(a)(13).

To buttress this holding, the bankruptcy court employed a second maxim of statutory interpretation, namely, that a statute must be interpreted so as to give meaning to all of its parts. In order to do this in the context of Chapter 7, the bankruptcy court found it necessary to construe §523(a)(13) and §523(a)(7) as mutually exclusive:

> Section 523(a)(7) of the Code is concerned with the dischargeability of fines and penalties, with no distinction between state and federal penalties, and expressly excludes "compensation for actual pecuniary loss" from its scope. Section 523(a)(13) is concerned with those obligations that section 523(a)(7) expressly does not cover: restitution, and does not address fines or penalties. As a result, under section 523(a)(7) of the Bankruptcy Code, fines and penalties are not dischargeable, but compensation for pecuniary loss is dischargeable. However, under section 523(a)(13) of the Code, federal restitution . . . is not dischargeable.

(July 7 order at 19). If §523(a)(7) was construed as excepting from discharge all civil and criminal restitution orders considered penal in nature, then §523(a)(13) would be rendered superfluous. Accordingly, the bank-

ruptcy court found that §523(a)(13) exclusively governs the dischargeability of all forms of restitution.

The State disagrees with each of the doctrines of statutory interpretation that the bankruptcy court applies, and offers competing doctrines which it asserts provide more useful guides to understanding the relationship between §523(a)(13) and §523(a)(7). First, the State objects to the bankruptcy court's application of the doctrine *inclusio unius est exclusio alterius*, and instead offers different maxims which it says lead to the correct result here. Specifically, the State asserts that "if there has been a judicial construction of a statute, the language of which has not been changed upon subsequent amendment of other portions of the statute, it must be presumed that Congress was satisfied with and adopted the judicial construction given the unchanged portion of the statute" (Appellant Br. at 7). In addition, the State contends that "the rules of statutory construction require that if Congress codifies existing judicially created law, or amends an existing statute, it is deemed to have adopted the existing judicial interpretation, absent a clear Congressional manifestation of contrary intent" (Appellant Br. at 8). Applying these maxims, the State argues that since §523(a)(13) was enacted well after the decision in *Kelly* (which exempted restitution from discharge), and since no explicit changes were ever made to §523(a)(7), this court must find that the judicial construction given to §523(a)(7) by *Kelly* still applies.

This case thus presents a novel issue: whether the addition of §523(a)(13) should, as the bankruptcy court argues, be interpreted as superseding the judicial construction given §523(a)(7) by the *Kelly* court, or if it

should be viewed, as the State argues, as an independent provision that does not alter the judicial construction of §523(a)(7). We find that to the extent that criminal and civil restitution obligations were considered nondischargeable as "fines, penalties, and forfeitures" under §523(a)(7), that result should continue despite the addition of §523(a)(13). We therefore reverse the bankruptcy court's order to the extent it held that the issue of the dischargeability of restitution obligations was controlled exclusively by §523(a)(13).

This conclusion is supported by several factors, the most important being §523(a)(13)'s relation to the Supreme Court's decision in *Kelly*. This relation is best described by the following analysis:

> The Court in *Kelly* held that state criminal court ordered restitution was more like a criminal fine that could not be excepted from discharge under Code §523(a)(7). The holding turned in part on a finding that congress had not intended to legislatively overrule "the history of bankruptcy court deference to criminal judgments and in light of the interests of the States in unfettered administration of their criminal justice system." 479 U.S. at 43-44. Thus, the holding was influenced, in part, by concerns of federalism, concerns not applicable with respect to restitution ordered by federal criminal courts. Although the general rationale of the case applies equally to federal as well as state criminal court restitution orders, ambiguity could arise with respect to the application to federal criminal court restitution orders in light of the federalism concern.
>
> Thus, new Code §523(a)(13) may be properly viewed as closing a loophole with respect to res-

> titution ordered by a federal criminal court, a loophole which does not exist with respect to state criminal court ordered restitution. The net effect appears to be that restitution ordered by a federal criminal court will be excepted from discharge pursuant to Code §523(a)(13) as restitution. No further analysis is needed. With respect to state criminal court ordered restitution, however, courts should continue to determine whether the restitution is excepted from discharge under Code §523(a)(7) which, for most courts, requires a finding that the restitution in question is penal, rather than pecuniary, in nature.

3 Norton Bankr. L. & Prac. 2d §47:46 (1997).

Thus, contrary to the bankruptcy court's conclusion, we believe that the narrow language of §523(a)(13) was not meant to exclude all other forms of restitution from possible nondischargeability; rather, it was meant to clarify the existing scheme by emphasizing that federal criminal restitution orders—which were arguably not included in the Supreme Court's expansive reading of §523(a)(7) in *Kelly*—were in fact nondischargeable in Chapter 7 proceedings. The doctrine of *inclusio unius est exclusio alterius* therefore does not apply here. Section 523(a)(13)'s silence has a different meaning than the one attributed to it by the bankruptcy court—silence in this case means acceptance of the previous judicial construction of §523(a)(7). *See Johnson v. First Nat. Bank of Montevideo, Minn.*, 719 F.2d 270, 277 (8th Cir. 1983) ("Absent a clear manifestation of contrary intent, a newly enacted or revised statute is presumed to be harmonious with existing law and its judicial construction"), *cert. denied*, 465 U.S. 1012 (1984). Moreover

(and again contrary to the conclusions of the bankruptcy court), this reading of the relation between (a)(7) and (a)(13) gives independent meaning to each one: (a)(13) fills a gap in statutory coverage by affirming that persons convicted of *federal* and *state* crimes cannot be relieved of their obligations to make penal restitution. Accordingly, we conclude that §523(a)(13) does not control the issue of whether state and non-title 18 federal restitution orders are nondischargeable. That question must be answered pursuant to §523(a)(7) in accordance with the criteria set forth in *Kelly*.

This conclusion is also buttressed by the following considerations. First, we note the fact that courts in other jurisdictions continue to evaluate the dischargeability of state and non-title 18 restitution obligations under §523(a)(7). *See, e.g., In re LaRoche*, 207 B.R. 369, 371 (Bankr. D.R.I. 1997). In addition, as the State points out, §523(a)(13) was passed as part of the omnibus Violence Crime Control and Law Enforcement Act of 1994. This Act was passed to

> encourage the use of community policing through assistance to States and local governments to increase . . . the number of officers walking our nation's police beats over the next six years, as well as to facilitate non-hiring community policing objectives. A key element in President Clinton's anti-crime program, H.R. 3355 provides $3.45 billion in grants to States and local governments for use in hiring officers to engage in implementing community policing.

H.R. Rep. No. 103-324 at 6 (1994), *reprinted in* 1994 U.S.C.C.A.N. 1082, 1083. Within the context of this statutory scheme, concerned as it is with the prevention

and punishment of crime, it would be anomalous for this court to find that §523(a)(13) was adopted with the specific purpose of *relieving* persons convicted of wrongdoing of their obligation to pay court-ordered restitution.

Finally, it should be noted that Congress' expressed intention to treat restitution claims similarly under Chapters 7 and 13 weighs in favor of our finding. Section 1328(a)(3), which was passed in 1990, added an exception to discharge for any debt "for restitution, or a criminal fine, included in a sentence on the [Chapter 13] debtor's conviction of a crime." 11 U.S.C. §1328(a)(3). In this case, the bankruptcy court pointed to §1328(a)(3) as an example of Congress knowing how to specify that it intended to make *all* types of criminal restitution nondischargeable, and argued on that basis that §523(a)(13)'s narrow language was intended to make all other forms of restitution (*i.e.*, state and non-title 18 federal restitution orders) dischargeable in Chapter 7 proceedings. However, this reading of the relation between Chapter 13 and Chapter 7 seems wrong in light of the legislative history surrounding the 1990 passage of §1328(a)(3). There, Congress took pains to recognize that §1328(a)(3) was "not intended to alter in any way the coverage of section 523(a)(7), as that paragraph has been interpreted in *Kelly v. Robinson* [citations omitted] to make criminal restitution obligations nondischargeable in Chapter 7." *In re Hardenberg*, 42 F.3d 986, 992 n. 6 (6th Cir. 1994) (citing H.R. Rep. No. 681(I), 101 Cong., 2d Sess. 165, *reprinted in* 1990 U.S.C.C.A.N. 6472, 6571). Thus, rather than manifesting Congress' intent to treat Chapter 13 and Chapter 7 debtors differently, a review of the legislative history of §1328(a)(3) demonstrates Congress' intent to maintain intact the

judicial interpretation of §523(a)(7) articulated in *Kelly* and ensure that "no debtor with criminal restitution obligations will be able to discharge them through any bankruptcy proceeding." *Id.*

In conclusion, we find that §523(a)(13) does not preclude our consideration of whether Tower's civil restitution obligation is excepted from discharge under §523(a)(7). We note that we make this holding with some trepidation, as the intent of Congress in enacting §523(a)(13) is by no means clear and is subject to contrasting interpretations, as demonstrated by the bankruptcy court decision in this case. We note that this issue is one that is ripe for definitive resolution by the Seventh Circuit. We turn now to an analysis of the merits of the State's claim that the restitution order at issue is nondischargeable under §523(a)(7).

II. The Dischargeability of Civil Restitution Orders Under §523(a)(7)

Our finding that §523(a)(7) covers the dischargeability of the restitution order in this case does not dispose of the issue. In order for the State to prevail, it has to demonstrate that the civil restitution order assessed against Towers in the state court Consumer Fraud Act case meets the criteria for exception from discharge set forth in §523(a)(7).[5]

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[5] Although the bankruptcy court did not rule on the merits of this issue, we find it appropriate for us to do so here, rather than remand to the bankruptcy court, since the parties in this case both have briefed the issue extensively to the bankruptcy court and here on appeal.

By virtue of §523(a)(7), debts which are for (1) fines, penalties, and forfeitures, (2) payable to a governmental unit, and (3) are not compensation for pecuniary loss are excepted from discharge. The question we face in this case is whether the civil restitution order here was "for the benefit of a governmental unit" and "not compensation for actual pecuniary loss." The Supreme Court in *Kelly v. Robinson* addressed these issues in the context of a Chapter 7 bankruptcy proceeding filed by a debtor seeking to discharge, *inter alia*, a restitution payment in the amount of $ 100/month ordered by the State of Connecticut as part of her sentence for wrongfully receiving state welfare payments. 479 U.S. at 38-39. The Court held that §523(a)(7) creates a broad exception for all penal sanctions, including restitution orders, imposed by a state criminal court as part of a criminal sentence. 479 U.S. at 50-53. In discussing the rationale for its decision, the Court stated as follows:

> The criminal justice system is not operated primarily for the benefit of victims, but for the benefit of society as a whole. Thus, it is concerned not only with punishing the offender, but also with rehabilitating him. Although restitution does resemble a judgment "for the benefit of" the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of restitution awarded or over the decision to award restitution. Moreover, the decision to impose restitution generally does not turn on the victim's injury, but on the penal goals of the State and the situation of the defendant.

Id. at 52. The Court went on to emphasize that criminal proceedings such as the one at issue in the case focused

on "the State's interests in rehabilitation and punishment, rather than the victim's desire for compensation," *id.* at 53, and for that reason restitution orders imposed in such a context were excepted from discharge under §523(a)(7). Therefore, the Court concluded that criminal restitution orders qualify as nondischargeable "fines" that are not debts for "actual pecuniary loss." *Id.*

However, the Supreme Court left open the issue of whether restitution ordered as part of a civil fraud judgment obtained in furtherance of a state's law enforcement purposes, such as the one we are faced with here, is nondischargeable. The State relies heavily on *United States Dept. of HUD v. CCMV*, 64 F.3d 920 (4th Cir. 1995), in support of its position that civil restitution orders are in fact nondischargeable.[6] In *CCMV*, the Fourth Circuit found that a civil order requiring the disgorgement of ill-gotten profits assessed against a land developer that failed to comply with the registration and disclosure provisions of the Interstate Land Sales Full Disclosure Act, was excepted from discharge under §523(a)(7). *Id.* The court followed the "broad reading" the Supreme Court had given to §523(a)(7) in *Kelly* and *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990) (stating that §523(a)(7) applies to both criminal and civil fines),

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[6] Towers argues that *CCMV* is not applicable in the instant case because the doctrine of collateral estoppel does not apply. However, as already explained by the bankruptcy court judge, (July 7 Order at 13), the collateral estoppel preclusive effect of the final judgment in this case is irrelevant to this court's determination of whether the restitution order is nondischargeable under §523(a)(7) since that subsection does not require a showing of culpability.

superseded by statute on other grounds, in finding that the disgorgement was "penal" in nature and therefore nondischargeable. *Id.* at 928. The court stated that "so long as the government's interest in enforcing a debt is *penal*, it makes no difference that injured persons may thereby receive compensation for pecuniary loss. In other words, the 'not compensation for actual pecuniary loss' phrase in §523(a)(7) refers to the *government's* pecuniary loss." *Id.* (emphasis in original). Under *CCMV*, then, a civil order may be nondischargeable if it advances the state's penal interests, irrespective of whether individual victims may eventually be compensated for their losses or the government may be compensated for its loss.

The bankruptcy court in *In re Taite*, 76 B.R. 764 (Bankr. C.D.Cal. 1987), took a different view of the dischargeability of civil restitution orders. In that case, the debtors had been found guilty by a California state court of "unlawful, unfair, and fraudulent business practices" in connection the sale of carpet materials and services, and were ordered to pay $265,645 as partial restitution. *Id.* at 766. The bankruptcy court held that §523(a)(7) "should not be extended to include civil restitution judgments obtained by the State on behalf of victims of a consumer fraud scheme, because they are primarily 'compensation for actual pecuniary loss.'" *Id.* at 773. The court based this decision in part on the absence of the "compelling state interest in the criminal sentencing process that was key" in *Kelly*. *Id.*[7]

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[7] The court also relied heavily on the fact that granting automatic nondischargeability under §523(a)(7) would create an

(continued...)

From these cases we draw the following conclusions to guide our decision. First, we must look at the civil restitution order in light of the purposes of the underlying state statutory scheme in order to determine whether the order was made to vindicate the State's interest in "punishment," *Kelly*, 479 U.S. at 53, or whether it was primarily intended to compensate the individual victims for their losses. *In re Taite*, 76 B.R. at 772. In making this assessment, we must keep in mind the fact that the overriding purpose of an order may be penal, even though "injured persons may thereby receive compensation for pecuniary loss." CCMV, 64 F.3d at 928. This is especially true where the "victim has no control over the amount of restitution awarded or over the decision to award restitution." *Kelly*, 479 U.S. at 52. A restitution order is penal as long as it is not compensation for actual pecuniary loss incurred by the government. *CCMV*, 64 F.3d at 928.

We turn now to an analysis of the specific restitution order in this case. That order was issued against

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[7] (...continued)
asymmetrical outcome, depending on who filed the complaint, the State or individual creditors. The court noted that "if the actual victims had obtained their own fraud judgments against Debtors, . . . they could have filed complaints to determine the nondischargeability of their restitution awards under 11 U.S.C. §523(a)(2)." *Id.* It concluded that the "identity of the creditor holding a civil restitution award should not control whether the bankruptcy court is deprived of its exclusive jurisdiction to determine dischargeability of compensatory civil fraud judgments. Such a result would be contrary to one of the major thrusts of the Bankruptcy Reform Act of 1978—to classify claims, not creditors." *Id.* We do not address the relevance of this issue here since, as noted above, the statute of limitations for any claims under §523(a)(2) has expired.

Towers pursuant to the Illinois Consumer Fraud and Deceptive Practices Act and provided as follows:

> Percy Middleton and James Towers are hereby ordered to pay the amount of Two Hundred Ten Thousand Eighty Two Dollars and Thirty Four Cents ($210,082.34) as restitution to the consumers harmed by defendants' unlawful acts and business practices, as provided by Section 7 of the Consumer Fraud Act. A list of the names and addresses of consumers and the amount of the restitution to each is attached as Appendix A.

(Appellant Doc. 1 at 4). Applying the guidelines developed above, we find that the overriding purpose of this restitution order was to vindicate the State's interest in punishing wrongdoing, not to directly compensate the victims of Towers' fraudulent activities. As such, we find that the civil restitution order at issue in this case is not dischargeable under §523(a)(7).

This conclusion is supported by the text of Section 7 of the Illinois Consumer Fraud and Deceptive Practices Act, which formed the basis for the state court's order, as well as the Act's stated legislative purpose. Section 7 provides in relevant part as follows:

> Whenever the Attorney General or a State's Attorney has reason to believe that any person is using, has used, or is about to use any method, act or practice declared by this Act to be unlawful, and that proceedings would be in the public interest, he or she may bring an action in the name of the People of the State against such person to restrain by preliminary or permanent injunction the use of such method, act or practice. The Court, in its discretion, may exercise

> all powers necessary, including but not limited to: . . . restitution.

815 ILCS 505/7. According to section 7, the Act is designed to protect the public interest through the prevention of unlawful business practices. Although the Act is not exclusively penal, it is designed "to protect Illinois consumers, borrowers, and businessmen against fraud, unfair methods of competition, and other unfair and deceptive business practices. The Act is clearly within the class of remedial statutes which are designed to grant remedies for the protection of rights, introduce regulation conducive to the public good, or cure public evils." *Scott v. Association for Childbirth at Home, International*, 430 N.E.2d 1012, 1017 (Ill. 1981). Thus, even though the order specifies names of injured consumers and the amounts owed to each, the context in which the order was imposed—as the result of an action brought by the State to prevent fraudulent and deceptive trade practices—undermines the conclusion that it was compensatory. *Kelly*, 479 U.S. at 41.

Towers disputes this conclusion, arguing instead that there "is no basis anywhere in the common law or in plaintiff's pleading to justify calling the award anything other than pecuniary restitution to specific consumers listed in the Judgment . . ." (Appellee Br. at 4). On this point the bankruptcy court agrees with Towers, stating that because "the state court judge separately provided for penalty, costs and restitution, it is clear that the restitution must be different from a penalty or a cost, and that the state court judge intended the restitution to be treated as restitution . . ." (July 7 order at 19). However, the fact that specific consumers are listed in the restitution order does not require that we view the

order as compensatory and not pecuniary. *CCMV*, 64 F.3d at 928. Here, other considerations militate against a finding that the order was purely compensatory. In addition to the textual support from the Illinois Consumer Fraud Act itself, we also note that the victims in this case had no control over the amount of the restitution award and are not entitled to recover any monies awarded to the State. *See Kelly*, 479 U.S. at 53. Moreover, the order was not issued to recover any pecuniary loss incurred by the government and therefore should be treated as a nondischargeable debt under §523(a)(7). *CCMV*, 64 F.3d at 928.

Therefore, in conclusion, we find that the restitution order issued by the state court in this case is properly characterized as a debt excepted from discharge under §523(a)(7). As a result, we reverse the bankruptcy court's contrary finding and grant the State's motion for summary judgment on this issue. We note again, however, that this issue is not without ambiguity and is one that is ripe for resolution by the appellate court.

CONCLUSION

For the foregoing reasons, the bankruptcy court's July 7 order is reversed in part and the appellant State of Illinois' motion for summary judgment is granted.

/s/ James B. Moran
JAMES B. MORAN
Senior District Judge,
U.S. District Court

Jan. 30, 1998

[Dated January 30, 1998]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
Eastern Division

IN RE: JAMES TOWERS

JUDGMENT IN A CIVIL CASE

v.

CASE NUMBER: 97 C 6005 (95 A 00329)

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the bankruptcy court's July 7 order is reversed in part and the appellant State of Illinois' motion for summary judgment is granted.

January 30, 1998
Date

MICHAEL W. DOBBINS
Clerk

/S/ Willie A. Haynes
(By) Deputy Clerk

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

January 12, 1999

Before

Hon. RICHARD A. POSNER, Chief Judge
Hon. WILLIAM J. BAUER, Circuit Judge
Hon. FRANK H. EASTERBROOK, Circuit Judge

No. 98-1522	)	
	)	Appeal from the United
IN THE MATTER OF:	)	States District Court
	)	for the Northern
JAMES TOWERS,	)	District of Illinois,
Debtor-Appellant,	)	Eastern Division.
	)	
	)	No. 97 C 6004
STATE OF ILLINOIS,	)	James B. Moran, Judge.
Appellee.	)	

Order

Appellee filed a petition for rehearing and suggestion of rehearing en banc on December 23, 1998. No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.